

LEASING-COURIER



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<http://www.ifc.org/russianleasing>

JANUARY-FEBRUARY 2002, Issue 1 (19)

ON AMENDMENTS AND ADDENDA TO THE FEDERAL LAW «ON LEASING»

The Russian president signed the law "On Amendments and Addenda to the Federal Law 'On Leasing'" on January 29, 2002. The amended law "On Leasing" establishes a clearer legal framework for leasing in Russia, which will in turn help activate the development of investment via leasing and lead to more widespread use of leasing for renewing capital equipment in Russia.

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THE IFC TAKES ITS LEASING EXPERTISE TO CENTRAL ASIA

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CARDBOARD PRODUCTION IN NIZHNY NOVGOROD

The Nizhkarton company has acquired most of its equipment under leasing contracts. In the three years that have passed since it originally acquired its current equipment, the company – a start-up – has become one of the largest producers of corrugated cardboard and cardboard packaging in the Volga Federal District.



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CARDBOARD PRODUCTION IN NIZHNY NOVGOROD

*Eleonora Veitsman
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IFC Leasing Development Group*

The idea of establishing a company to produce corrugated cardboard came to one of its directors, Alexei Valentinovich Loginov, in 1997. About a year was spent studying the market and searching for financing. Despite the fact that the banks that Loginov approached for loans proposed the same conditions for financing as Nizhny Novgorod Leasing Company, a choice was nevertheless made in favor of leasing. One of the factors that influenced this decision was the informal approach of the leasing company to the potential client and the experience and professionalism of its specialists.



*Alexei V. Loginov,
Director of Nizhkarton Company*

At the end of the third quarter of 1998, with the feasibility study written and all the necessary documents gathered, Nizhkarton submitted an application to the Nizhny Novgorod Leasing Company. The leasing company quickly reached a

decision to grant the funds. A three-year leasing agreement was signed in November, and by December the company had received its first corrugated cardboard production line. The first sheets of corrugated cardboard were produced in March 1999. At the time production began, only four people worked at the company.

By the start of 2000 the Russian consumer market finally recovered from the financial crisis in August 1998. Business for the main consumers of corrugated cardboard – food, pharmaceutical and household chemical companies – took off. Due to increased consumer demand, Nizhkarton decided to expand its presence on the market. To do this, the company needed to increase its production significantly, as its capacity at the time did not meet the growing demand.

The entrepreneur approached Nizhny Novgorod Leasing Company for more financing. The company acquired the equipment needed by the client and



Corrugated cardboard production line

leased it to him. Two new leasing contracts, both for one year, were signed for the new equipment – another corrugated cardboard production line and a unit to punch cardboard boxes out of these sheets.

As a result of the purchase of the new equipment, production and sales at Nizhkarton more than doubled, as did the company's profits. This in turn led to the creation of new jobs (the company now employs 96 people), wage increases and also to a significant increase in Nizhkarton's market share. Today Nizhkarton not only services companies in the Volga region, but even exports its products to the Central and Northwest federal districts.

Increased business has allowed the company not only to meet its leasing payments successfully, but also to develop production further. By reinvesting profit, Loginov has acquired a box-printing unit and

Looking back, Alexei Valentinovich Loginov speaks with gratitude of the help that was provided for developing a feasibility study by company economists, lawyers, and marketing specialists, and recommends that potential lessees involve leasing company employees in the joint development of projects. "If we had not used the services of a leasing company, we would probably have been able to set up our company anyway. It would have worked, but it would have been different. Why? Theory and calculations is one thing – practice is another. When we started we had no experience and we didn't take a lot of things into consideration, whereas the leasing company, which before my time had carried out dozens of projects, already had this experience."

has bought vehicles to transport the finished product to consumers. "We started from zero and leasing helped us a lot," the entrepreneur said, adding, "the company is now firmly established and has even more potential." The entrepreneur has already drawn up a plan to develop the business further. First of all, he plans to continue expanding production and acquiring new equipment, which will open new production possibilities for the company. In addition, Loginov is also considering entering other areas of the packaging market. This means that Nizhkarton and Nizhny Novgorod Leasing Company will continue to cooperate, as Alexei Valentinovich directly links the future success of his plans with leasing.



Machine for printing on cardboard boxes

MICROLEASING, VOLKHOV

In issue No. 2(8) of Leasing Courier, we wrote about the Volkhov International Business Incubator, which works with small and mid-sized businesses in Leningrad region. More than a year ago, the Microleasing company was established at the business incubator. The IFC Moscow office met with Lyubov Victorovna Galakhova, General Director of Microleasing, and Ida Shmertz, Chair of the board of directors and Vice President of the Alliance of American and Russian Women. The two women spoke of the challenges facing Microleasing, the principles of the company's work and its potential, in an interview with Leasing Courier Editor Victoria Struts, the text of which follows:

Victoria Struts: To begin with, a little history - how and why did Microleasing appear?



*Lyubov V. Galakhova,
General Director of Microleasing*

Lyubov Galakhova: Microleasing is the offspring of Volkhov International Business Incubator, set up in 1995 at the initiative of the administration in the city of Volkhov and the Alliance of American and Russian Women. In addition to providing a range of services for small business – consulting support, providing space and office ser-

vices to budding entrepreneurs – the business incubator carries out the function of a training center and provides financial support to entrepreneurs, so as to develop business activity in the region. Special attention is paid to businesses run by women.

With time, demand for leasing services in the region

had grown to such an extent that it became necessary to set up a special structure to provide this service. As a result, in December 1999 a separate legal entity was established, registered as OOO Microleasing. Microleasing received a license in February 2000 and began to work independently in March.

V.S.: I would like to ask you Ida, why are North Americans so interested in developing leasing in Russia, especially among small companies?

Ida Shmertz: The fact is that North Americans have great respect for small business. The entire U.S. economy, for example, is founded on small and mid-sized business. By the way, the majority of small businesses, both in Russia and North America, are run by women and our experience shows that female managers show more responsibility with respect to their clients, pay on time and manage well. In my opinion, in this area Russians are similar to North Americans and can use our experience, software, marketing principles and franchising. I am convinced that the future of the Russian economy is small business. However, at the moment it is very difficult for private entrepreneurs to find credit in Russia, almost impossible.

The activity of organizations such as Microleasing is very important in developing this sector of the economy. For this reason foreign funds support the development of leasing programs aimed at developing small business.

Volkhov Business Incubator, set up in 1995, is special for two reasons: 60% of the business incubator's resources (space rented out, special programs) is provided to women entrepreneurs and are dedicated to developing their businesses. With the help of leasing programs, entrepreneurs are offered the possibility of receiving financing. The business incubator's leasing programs are designed for private entrepreneurs involved in agriculture, light industry, trade and the services market.

*Delovoi Peterburg (St. Petersburg),
December 6, 2001.*

V.S.: What are the sources of Microleasing's financing?

L.G.: Initially, leasing programs were carried out as part of a USAID grant provided to the Volkhov Business Incubator to support small business. Then TUS-RIF opened a credit line for Microleasing for two years. Now Microleasing has its own funds, earned since we started leasing.

V.S.: Who are your clients?

L.G.: In most cases, our clients are small companies – legal entities and a small number of farmers (i.e. the same small companies, only in the agricultural sphere). They also include private entrepreneurs that have not been formed into corporate entities. I would like to note that leasing companies usually don't work with this category of client and the

size of deals is frequently very small. Microleasing not only credits these entrepreneurs, but also provides legal support for their activity (including consultations on accounting, registers vehicles with the transportation authorities, etc.).

V.S.: Do you often have to begin by explaining the basics of leasing?

L.G.: Yes, and specifically for this reason we organize weekly free seminars. From the first day of Microleasing's operations, we have not veered from this tradition. As a rule, we not only explain our conditions for leasing, but also what exactly leasing is, how it differs from bank loans, how profitable it is. In addition, we look at different legal mechanisms for leasing deals, discuss legislation on which leasing is based and explain what documents may be necessary.

A lot of business people already have an idea of what leasing is, but when we speak of the specifics of a leasing deal, a seminar is necessary. With our specialists, we hold seminars both in Volkhov and in St. Petersburg. In summer, up to 50 people per week come to the seminars. These include potential lessees and repeat clients.

I.S.: Local suppliers also eagerly participate. Although Microleasing does not advertise its seminars, people find out themselves and attend on their own.

V.S.: I hope that IFC materials are of help to you.

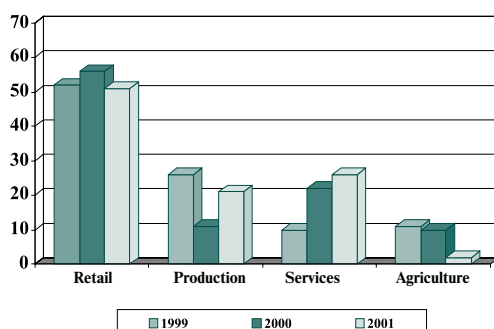
L.G.: Very much so; both in Volkhov and in St. Petersburg we have files of Leasing Courier, which can be used as textbooks and for reference. Our employees discuss every article. The economic and legislative articles are interesting, as are the articles on actual deals.

I.S.: Leasing knowledge and experience is distributed through the Russian regions largely thanks to IFC seminars. This is aided to a large extent by Leasing Courier. It is a professional publication, which we recommend to everybody that approaches us.

V.S.: Thank you for your kind words. Let us return to the theme of our conversation. Please tell me about the procedure for submitting applications to Microleasing.

I.S.: First of all we inform potential clients that Microleasing does not work with businesses con-

Lessees of Microleasing by Business Type





Ida Shmertz, Chair of the Board of Directors of Microleasing

nected with alcohol, tobacco, narcotics, non-ferrous metals and oil. We also do not work with the gaming business or with logging companies.

L.G.: We have certain methods for working with clients and we strictly adhere to all procedures. Experience shows that in this way we can achieve more

objectivity for the evaluation and rational use of human resources.

Microleasing receives dozens of new applications every month. Our employees responsible for credit evaluation carry out a preliminary analysis of all applications before the documents are approved. Then a small presentation of projects takes place and these are subject to group discussion. We look at the experience of the person, on the need for the project and how much the potential lessee understands what needs to be done. Using a finely developed computer system, each application is awarded a certain number of points on a 100-point scale. If the client accumulates more than 44 points at the stage of preliminary evaluation, the application is accepted. If this number of points is not accumulated, then we do not work with this client.

V.S.: So, the applicant receives the necessary number of points. What happens next?

L.G. The application goes through further analysis. All documents submitted by the applicant - certificates, financial documents - are verified. A Microleasing representative visits the location to familiarize himself with the business and draw up a summary. After this, the application is submitted for consideration by a credit committee. This committee contains independent experts - both Russian and American - a total of five people. One important detail: despite the fact that our organization pays special attention to women-entrepreneurs, in discussing projects, our experts never differentiate between "male" and "female" business. The criteria are the same for all - economic effectiveness, social significance, potential growth. The experts reach one of three conclusions "Yes," "No," and "Yes, if

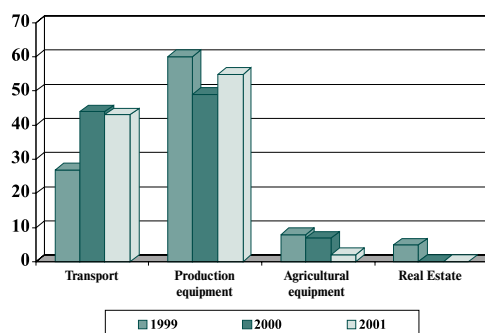
revised." As a result, the credit committee reaches a final decision on concluding the deal.

I.S.: This work takes a lot of time but it is done every time with every application submitted. In this way we manage to significantly reduce risks.

V.S.: Is any further security required for deals?

L.G. We try to enter into deals where the equipment itself is sufficient security.

Lessees of Microleasing by Equipment Type



V.S.: What size are the deals?

L.G. From five hundred to twenty five thousand U.S. dollars. Our average deal is, for example, for one Gazelle truck or some kind of machine tool, i.e. not large amounts.

I.S.: You know what is interesting in this work? A year or two ago our average deal was a little over one thousand dollars, then five thousand dollars and at the moment the amount has increased to seven thousand dollars. This is a positive trend.

V.S.: How about the number of clients?

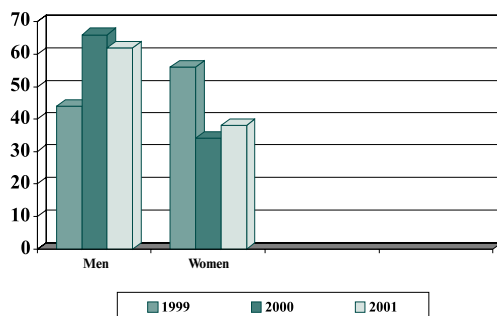
L.G.: In the four years the leasing program has existed, we have closed one hundred and forty deals. At the moment sixty-five deals are active.

V.S.: What is the geography of your activity?

L.G.: The Microleasing central office is located in the city of Volkhov in Leningrad region. We began in this district and then started to actively cooperate with business support centers throughout the Leningrad region. Microleasing opened an office in St. Petersburg in February 2001, and at the moment about 50% of our portfolio, in terms of the number

of clients and value of deals, is in the northern capital. The number of clients in Leningrad region is also growing, and last year we began to work with Vyborg and other remote cities.

Owners of Business



V.S.: Obviously Microleasing has managed to find its niche in the leasing market. What are the growth prospects?

L.G.: I have already mentioned that we receive over ten new applications every week. This indicates both that there are new clients and that demand for

leasing services exists. I am one hundred percent confident that today, leasing is what will help small and medium-sized business get on its feet.

I would like to add that 40% of our clients are repeat clients, i.e. small companies grow and improve their business. In the final analysis, this is our aim.

I.S.: I also believe that Microleasing has excellent growth prospects, as these services are much needed in the city and in the region. Today our portfolio amounts to about half a million dollars. We would like to find additional sources of financing, to invest money in leasing. This is a problem, though: finding investors in Russia that are prepared to invest in small business is not an easy task. We invite all interested organizations to cooperate with us!

V.S.: On behalf of Leasing Courier I wish Microleasing profitable operations, and your clients success in business!

Microleasing contact numbers:
In St. Petersburg (812) 118-69-80
In Volkhov (Leningrad region)
(81263) 26-401, 26-326.

ANALYSIS OF THE CURRENT FINANCIAL SITUATION OF POTENTIAL LESSEES

Analysis of working capital management (Calculation and analysis of turnover)

Elena Degtiareva
Financial Analyst, IFC Leasing Development Group

The financial situation of companies that are potential lessees directly depends on the principles of working capital management. In this article we will look at the calculation and interpretation of turnover indicators.

Analysis of working capital management

In one of the previous issues of Leasing Courier in our series of articles dedicated to minimizing risk, we looked at liquidity indicators and defined them as indicators that characterize the ability of a company to meet its current obligations. High liquidity indicators do not necessarily mean that a company has cash to make leasing payments, tax payments to the budget, wage payments, etc. This indi-

cator only shows that if a company's current assets are turned into cash, the company can meet its current obligations.

Assets turn into cash during a company's economic activity, but time is required to do so, and this depends on the specifics of each company's activity. For example, turnover may vary from several years in capital intensive sectors such as metallurgy and heavy engineering to several days for trading companies.

There are two ways of evaluating turnover. The first is by calculating the number of times the asset base



Elena Degtiareva
Financial Analyst, IFC Leasing
Development Group

is turned over in each period of analysis; the second is to establish the period of time in which turnover of the asset base takes place. These indicators are equivalent, but expressed in different units – times and days respectively. For example if, using the first method, we see

that the turnover of a finished product in a month is equal to 2, this will correspond with a turnover period of 15 days when using the second method. As a rule, in practice it is more common to present turnover indicators in days, as this indicator is more convincing, especially in comparative analysis, and does not depend on the definition of the period.

Turnover analysis allows us to determine the period of time it takes for a company to recoup investment in its core activity in the form of revenue.

Initially a company (if it is involved in production) spends money on inputs. If prepayment is a condition for the supply of material resources, then money is transformed into advances to suppliers. From the moment materials are delivered to the warehouse until their use in production, the company's money is represented by reserves of inputs. Afterwards it is in the form of finished goods, accounts receivable and in the end returns to the company in the form of money.

A certain period of time passes in which money, having been transformed into each element of current assets, again returns to the company in the form of revenue in a settlement account¹. This period of

time (total duration of the turnover period for all current asset items) to a large extent depends on the nature of the production activity.

In a number of cases, depending on the specifics of a company's activity, some elements of the turnover cycle may not be present. For example, there may be no advance payments to suppliers, if payment for inputs is carried out day-to-day or in installments (when accounts payable appear); and there may be no accounts receivable, if buyers prepay for products (advances on the part of the buyer).

Turnover periods may be calculated from information contained in the balance sheet and profit and loss accounts of a potential lessee comparing current asset balances and their turnover in an analysis period. In establishing the turnover period for current asset items, these turnovers are:

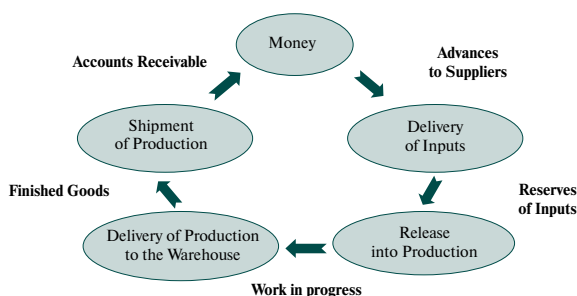
- sales revenue (for accounts receivable) and
- cost of sales (for reserves of raw materials, work-in-process, finished goods and advances to suppliers).

In a previous issue of Leasing Courier (No. 3 [15], May-June 2001), we looked at the analysis of asset and liability line items, and particularly at the analysis of working capital. Growth or sudden changes in current assets in absolute terms do not necessarily indicate an irrational working capital structure. This only shows the need to carry out a further, more thorough analysis of the corresponding items on the balance sheet, including an analysis of turnover.

Let us look more closely at how turnover periods for current assets and liabilities are calculated and what value they provide in analyzing a potential lessee.

The turnover period for advances to suppliers.

The turnover period for advances to suppliers shows how much time, on average, passes from the moment payment is made for raw materials and components to the moment they are delivered to the warehouse (average prepayment period). Therefore this indicator is considered as a ratio of the average size of advances to suppliers in the analysis period to money spent on raw materials and components. Insofar as leasing companies, as a rule, cannot separate material costs from all production costs in reports supplied by a potential lessee, this indicator is established by using information on the cost of



¹ In this case we are not looking at non-monetary forms of settlement.

production, work and services (line 020 of the Profit and Loss Account).

$$\begin{aligned} &\text{Turnover period of advances to suppliers} \\ &= \\ &\frac{\text{Advances paid (average)}}{\text{Cost / length of interval}} \\ &= \\ &\frac{(\text{Pg. 245 of Balance Sheet}_t + \text{Pg. 245 of Balance Sheet}_{t-1})/2}{\text{Line 020 of Profit and Loss Accounts / interval duration}} \end{aligned}$$

Growth in this indicator occurs when growth in the size of advance payments to suppliers outstrips the pace of growth in production (growth in costs). Increased periods for prepayment of raw materials more than likely indicate worsening relations between a company and its suppliers (suppliers refuse to grant supplier credits).

Turnover period for material reserves

The turnover period for material reserves shows how much time, on average, passes from the moment material reserves are supplied to the warehouse to the moment they are used in production (average period of storage in warehouse). As production reserves are accounted for at the cost of their acquisition, the cost of the sold product is used in calculating the turnover ratio of reserves.

$$\begin{aligned} &\text{Turnover period of raw materials} \\ &= \\ &\frac{\text{Reserves of raw materials (average)}}{\text{Cost / length of interval}} \\ &= \\ &\frac{(\text{Pg. 245 of Balance Sheet}_t + \text{Pg. 254 of Balance Sheet}_{t-1})/2}{\text{Line 020 of Profit and Loss Accounts / interval duration}} \end{aligned}$$

Significant periods of storage of material in warehouses may be the result of an irrational purchasing policy, which may, for example, be due to territorial remoteness from suppliers (large transport costs) or discounts offered by the supplier for certain purchase volumes.

If, in this analysis, constant growth or significant changes in the periods of supplies of materials to warehouses is observed, this might be a signal of the need to carry out a more detailed analysis of warehouse material structures (uncovering the share of the non-rotating part of reserves) and an analysis of the relationship between the company and suppliers. However, changes in this indicator may also be seasonal.

Turnover period of work-in-process

The turnover period of work-in-process shows the average cycle of production, i.e. how much time passes from the moment materials are used in production until they are delivered to the warehouse in the form of finished goods.

$$\begin{aligned} &\text{Turnover period of Work-in-Progress} \\ &= \\ &\frac{\text{Work-in-Progress (average)}}{\text{Cost / interval length}} \\ &= \\ &\frac{(\text{Pg. 213 of Balance Sheet}_t + \text{Pg. 213 of Balance Sheet}_{t-1})/2}{\text{Line 020 of Profit and Loss Accounts / interval duration}} \end{aligned}$$

On the whole, we can say that the smaller the period of turnover of work-in-progress, the less funds are tied up in this less liquid group of assets.

Growth in this indicator due to increased balances of work-in-progress, may be a negative trend - but only if growth in work-in-progress is due to an increase in its non-rotating "frozen component." Growth in the balance sheet value of work-in-progress and the corresponding calculated turnover period may occur if a long production cycle is required to produce the finished product, and the analysis interval is shorter than the production cycle - for example, if a company's main activity is airplane construction, which takes a year on average, and analysis is carried out on a quarterly basis. Then, from the moment construction is started until it is completed, we will see growth in the balance sheet entry "work-in-progress" and growth in the calculated turnover period. In this case, this would not necessarily be a negative characteristic of the company's activity, but a normal process.

Turnover period of finished goods

The turnover period for finished goods shows how much time on average passes from the moment a finished product arrives in the warehouse until it is supplied to a buyer (storage period of finished product in the warehouse). This indicator is defined as the ratio of the average balances of finished goods in a period to the cost per day.

$$\begin{aligned} &\text{Turnover period of Finished product (average)} \\ &= \\ &\frac{\text{Finished product (average)}}{\text{Cost / interval length}} \\ &= \\ &\frac{(\text{Pg. 214 of Balance Sheet}_t + \text{Pg. 214 of Balance Sheet}_{t-1})/2}{\text{Line 020 of Profit and Loss Accounts / interval duration}} \end{aligned}$$

A reduction in the turnover period of a finished product may indicate increased demand for this product from buyers, while an increase in the amount of storage time of a product in the warehouse may indicate the opposite: the unwillingness of buyers to acquire the product. We should keep in mind that changes in demand may occur due to market conditions that are characteristic for the type of product (such as seasonal demand) or changes in the competitiveness of the product on the market. This means that an increase in the turnover period may indicate a negative trend, or be standard for the market. It is also possible that growth in balances of finished products in the warehouse, and the resulting increase in the storage period, is company policy.

Turnover period for accounts receivable

The turnover period for accounts receivable shows how much time passes from the moment a product is delivered from the warehouse to the moment payment arrives in the settlement account or cash register of the company (the payment period for invoices supplied to buyers). This indicator is calculated as a ratio of the average cost of the product supplied, accounts receivable of the buyer and contractor and bearer promissory notes, to the volume of daily revenue at the company.

$$\begin{aligned} &\text{Turnover period of Accounts receivable} \\ &= \\ &\frac{\text{Accounts receivable (average)}}{\text{Sales revenue / interval length}} \\ &= \\ &\frac{[(\text{Pg. 215} + \text{pg. 242 of Balance Sheet})_t + \\ &+ (\text{Pg. 215} + \text{pg. 241} + \text{pg. 242 of Balance Sheet})_{t-1}] / 2}{\text{Line 010 of Profit and Loss Accounts / interval duration}} \end{aligned}$$

A positive characteristic indicating an improvement in relations with buyers of the company's products is a reduction in the turnover period of accounts receivable (reduction in the amount of time payment is made for products supplied).

The opposite is also true: growth in the turnover of this indicator, as a rule, is a negative characteristic in relations between the company and buyers, and occurs when growth in accounts receivable outstrips growth in sales revenue, and indicates growth in crediting of product buyers. This may indicate difficulties in receiving funds from the accounts of debtors (for example, due to the low solvency of clients), be a result of the relations with buyers that have developed at the company, or the absence at the company of control over payment for products supplied.

Consequently, growth in the turnover period of current assets, as a rule, is a negative indicator of the management of working capital. This indicates an increase in the period of time in which money is tied to a certain item of current assets, which in turn leads to the need to use additional company funds or borrowed funds to replenish working capital.

Turnover period of current liabilities

Accounts payable, buyers' advances, debt to the budget, debt to staff – these are the main elements of current liabilities. Turnover periods for current liabilities show the amount of time during which a company has the possibility of financing its activity at the expense of counterparties – for example, to use inputs until they are paid for and to delay payment for the supply of goods, work or services.

Turnover period of accounts payable

The turnover period of accounts payable is the average length of time before payment is made for goods and services.

$$\begin{aligned} &\text{Turnover period of Accounts payable} \\ &= \\ &\frac{\text{Accounts payable (average)}}{\text{Cost / interval length}} \\ &= \\ &\frac{(\text{Pg. 621 of Balance Sheet}_t + \text{Pg. 622 of Balance Sheet}_{t-1})/2}{\text{Line 020 of Profit and Loss Accounts / interval duration}} \end{aligned}$$

The larger the turnover period for accounts payable, the more profitable the relations between a company and its suppliers. On the other hand, in this case the company's operational risk increases and its financial stability declines. Obviously, if the growth in accounts payable is driven by an inability to pay its counterparties, the risk of being cut off is much higher.

Turnover period for advances

The turnover period for advances is the average period of prepayment for products made by consumers of the company's products.

$$\begin{aligned} &\text{Turnover period of Finished product} \\ &= \\ &\frac{\text{Buyers advances (average)}}{\text{Sales revenue / interval length}} \\ &= \\ &\frac{(\text{Pg. 627 of Balance Sheet}_t + \text{Pg. 627 of Balance Sheet}_{t-1})/2}{\text{Line 010 of Profit and Loss Accounts / interval duration}} \end{aligned}$$

All things being equal, an increase in the period of prepayment for goods, work and services, causing growth in the entry "advances received," indicates increased demand for the product sold by the company.

Turnover period for debt to the budget and workers

The turnover period for debt on the payment of taxes can be calculated by comparing the average size of debt to the budget (line 626 of the balance sheet) with the corresponding turnover per day, i.e. the size of tax payments, divided by the length of the analysis period.

The turnover period for wage debt can be calculated by dividing the average debt to workers (line 624 of the balance sheet) by the daily cost of wages.

We should note that both the size of tax payments and the size of wages in the analysis interval are internal information. Therefore establishing the indicator of turnover of debt to the budget and personnel and comparing these with regulatory turnover periods is, as a rule, not something which leasing companies can do as they lack this infor-

mation. In this case, the analysis can be limited to an evaluation of changes in the dynamic of the balance sheet entries "tax liabilities" and "wage debt", and a comparison with the company's sales dynamic.

The significance of turnover indicators directly depends on how much the accounting information reflects the real situation at a company. The results of calculations may change significantly after the correction of certain information. For example, excluding the overdue component from accounts receivable (information from an interpretation of accounts receivable) may lead to a significant reduction in the calculated turnover periods of this debt and bring it closer to its real level. Excluding the non-revolving "frozen" component from current assets (material reserves, work-in-progress, finished product) also makes it possible to calculate the turnover period more accurately. ■

With this article we wrap up the theme "Minimizing Leasing Company Risks Using Financial Analysis of a Potential Lessee."

ALTERNATIVE MEANS OF FINANCING LEASING DEALS: LEGAL ASPECTS

*Olga Shishlyannikova
Lawyer, IFC Leasing Development Group*

In this article we continue the theme of the legal aspects of financing leasing companies begun in Leasing Courier No. 6 (18) 2001. Last time out we considered the legal aspects of loan agreements and corporate methods of financing legal deals.

Financing agreements with assignment of monetary claim (factoring)

It is currently becoming more and more common to incorporate a company's accounts receivable in turnover, which may be carried out by entering into a financing deal using assignment of monetary claim (factoring). The essence of this deal is that a company receives money from a financial agent by assigning the right to debts owed by a third party (accounts receivable). The company that assigns the right to claim is usually interested in immediate receipt of funds owing, a reduction in the cost of servicing accounts receivable and partial or full insurance against the risk of insolvency of the debtor, or in the possibility of increased borrowing (since it is difficult to borrow against accounts receivable).

Chapter 43 of the Russian Civil Code is dedicated to the regulation of factoring. This form of financing is defined as a contract, on the basis of which one party (the financial agent) transfers or promises to transfer money to the other side (the client) based on the financial claim of the client (creditor) on a third party (debtor) for the provision by the client of goods, work or services to the third party, and the client assigns or promises to



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assign this claim to the financial agent (article 824 of the Russian Civil Code). Due to the fact that in practice, leasing activity is considered provision of a service, a leasing company may in principal use a factoring agreement by assigning to a financial agent the right to demand leasing payments from its lessees. Based on article 824 of the Russian Civil Code, financial claims on a debtor may be assigned to a financial agent to ensure the implementation of the client's obligations to the financial agent. Consequently, the lessor may also use its right to demand leasing payments as a means to secure credit agreements signed to attract funds to acquire the leased asset.

Finance agreements using factoring have much in common with cession agreements. At the moment there is no clear demarcation between these two types of agreements. The absence of a single definition in practice leads to Arbitration Courts handing down directly contradicting rulings on essentially identical deals. In our opinion, factoring agreements are a form of cession agreement, which means that agreements to assign monetary claim should be subject to regulations regulating assignment of claim (cession agreements) in the absence of special regulations in chapter 43 of the Russian Civil Code. In order to separate factoring agreements from similar contract relations (cession agreement, collateral agreements, credit agreement, etc.), the most significant and differentiating aspects are the fact that the assigned claim should be monetary and it should be assigned against a reciprocal provision of money by the party to which this claim is being assigned (or transferred as security).

So, if you have decided that the deal you are entering into is an agreement to assign monetary claim, then pay attention to the following aspects:

- In accordance with article 825 of the Russian Civil Code, financial agents may be banks, other credit organizations and also other commercial agents with a license to carry out this type of activity. We should note that there are no systems or conditions for licensing the activity of financial agents. However, according to article 10 of the federal law from 26.01.95 "On the Implementation of the Second Part of the Civil Code of the Russian Federation," until the establishment of conditions for licensing the activity of financial agents, the existing mechanism for carrying out their activity will remain in place. Since, when the second part of the Russian Civil Code was introduced, commercial organizations with general legal capacities could carry out factoring operations

without restriction, then we can say that at the present moment the activity of financial agents is not licensed. However, this point of view is not shared by all. On the contrary, court authorities presuppose that financial agents have special legal capacities, i.e. they consider a license to be obligatory¹. Consequently, so as to avoid possible disputes over the validity of a deal, we would recommend that leasing companies only enter into factoring agreements with banks or other licensed credit organizations.

- Even if your leasing agreement includes a ban or restriction on the assignment of monetary claim on this agreement, the leasing company still has the right to assign to a financial agent the monetary claim on the lessee with regard to the leasing payments due (article 828 of the Russian Civil Code). However, the lessor should remember that despite this clause, the leasing company is not freed from any duties or obligations in this respect written into the leasing agreement.

- According to general regulations set down in point 3 of article 827 of the Russian Civil Code, the lessor will not be responsible for non-implementation or improper implementation by the lessee of claims that are assigned, when they are presented by the financial agent to be honored. However, a factoring agreement may include a different level of responsibility of the leasing company to the financial agent, although the inclusion of such a restriction would significantly reduce the attractiveness of this form of financing for the lessor. We recommend that when including conditions in a finance agreement regarding the responsibility of the leasing company with regard to the lessee honoring the assigned claim, a list of circumstances for the absence or presence of which the lessor will be responsible before the financial agent should also be included.

- In settlements between the lessee and the financial agent, the latter receives the right to the entire amount that he can receive from the debtor when honoring the claim. This total may exceed the amount of the credit given to the leasing company and may be less than this amount – moreover, in this respect the leasing company has no responsibilities to the financial agent. The reverse regulation is covered by point 2 of Article 831 of the Russian Civil Code for cases when the assignment of monetary claim is car-

¹ See Russian Supreme Arbitration Court Presidium resolution No. 955/98 from 30.06.98.

ried out to guarantee the fulfillment of obligations (for example, the return by a leasing company of a credit granted to it). In this case it is possible (unless otherwise stated in the factoring agreement) to carry out additional settlements between the financial agent and the lessor depending on the actual amount received from the lessee. These settlements are carried out within the framework of other guarantee obligations – if the financial agent exacts an amount from the lessee in excess of the debt of the leasing company, he should transfer the corresponding difference to the latter, but if the amount received from the debtor is less than the debt of the lessor, the latter remains responsible for the remainder of the debt.

In concluding this discussion on lease financing using factoring, I would like to again touch on the issue of payment for financial agent services. In practice, the amount of payment under this type of

agreement is established based on a whole range of factors. In particular, it takes into consideration the risks being taken on by the financial agent, the period of time financing is granted to the leasing company, etc. Payment for financial agent services may be carried out in various forms: in the form of a percentage of the value of the assigned claim; as a fixed amount; or in the form of the difference between the market value of the claim and its contract value. Unfortunately, we have no information on payments that have actually been made on factoring agreements applied to leasing deals. However, as an example, we can take conditions for the provision of factoring services by the investment banking group NIKoil on supply contracts. This bank, for assigning accounts receivable, proposes financing of up to 85% until the payment of the debt by the buyer, and the remainder, minus the bank's commission, after the payment of debt. ■

DISSOLUTION OF LEASING CONTRACTS

Stanislav Kovynev
Lawyer, IFC Leasing Development Group

A leasing company, like any other business, is not insured against the risk of a counterparty not meeting his obligations. If the leasing company retains the right of ownership to the leased asset for the entire period of the leasing agreement, at first glance this makes its position more favorable, compared with creditors of the majority of other commercial deals. At the same time, contradictions in the law on leasing and the absence of real mechanisms for repossessing property significantly reduce the prospects of the leasing company protecting its rights and legal interests in the event of non-fulfillment or improper fulfillment by the lessee of his obligations.

Existing legislation¹, to an identical extent, guarantees protection of the rights of the owner and of the possessor² of the property. The right of ownership is also protected against claims by third parties and by the possessor. In addition, contradictions in provisions in article 13 of the law "On Leasing", despite their seemingly progressive character, make them practically unenforceable³.

Given the aforementioned, we will look in more detail at the norms of the Russian Civil Code regulating the dissolution of civil law contracts, including leasing agreements⁴.

Regulations in the Civil Code dealing with the early dissolution of civil contracts, including leasing agreements, can be divided into two groups: those regulating the dissolution of contracts in a judicial proceeding, and the extrajudicial dissolution of contracts (unilateral refusal to execute a contract). In this issue of Leasing Courier we will deal with individual issues regarding the dissolution of contracts through the courts.

¹ *IMPORTANT NOTICE: Since this article was prepared in Russian, amendments have been made to the Law on Leasing (see front page) which clarify prevailing law. This is particularly true where contradictions between the unamended Law on Leasing and other legislative acts. Please contact the LDG or see future editions of the Leasing Courier.*

² *Article 305 of the Russian Civil Code.*

³ *According to this article, unilateral dissolution of a leasing agreement is permitted on ground similar to the grounds for judicial dissolutions of an agreement, listed in article 619 of the Russian Civil Code.*

⁴ *As the majority of regulations in Russian legislation dealing with the dissolution of leasing agreements are concentrated in the general provisions of chapter 34 of the Russian Civil Code (rental agreements), for the convenience of the reader, in using these regulations the term «rent» will be replaced by the term «leasing».*



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In accordance with point 2 of article 450 of the Russian Civil Code, following a request from one of the parties to an agreement, a contract may be amended or dissolved based on a court ruling only:

1) in the event of a significant breach of the contract by the other side;

2) in other cases foreseen in the Russian Civil Code, or other laws or contracts.

According to the Russian Civil Code, the grounds for the early dissolution of a contract in a judicial proceeding at the initiative of the lessor are:

- use of the property involving a significant violation of the conditions of the agreement or the intended use of the property, or with repeated violations;
- significant deterioration or harm to the property;
- non-payment on more than two consecutive occasions of leasing payments by the date set in the agreement;
- not carrying out major repairs to the property in line with the schedule in the leasing agreement, and if these are not included in the agreement, within a reasonable amount of time in cases when, in accordance with the law, other legislative acts or agreements, the carrying out of major repairs is an obligation of the lessee.

Both article 450 and article 619 of the Russian Civil Code state that a significant breach of the conditions of a leasing agreement by the lessee is grounds for the early dissolution of an agreement.

In accordance with article 450 of the Russian Civil Code, a significant breach is understood as a breach of contract by one of the sides that causes such loss to the other side that it is to a significant extent deprived of that which it had the right to expect when entering into the agreement.

Given that non-payment (untimely payment) of leasing payments is listed in the Russian Civil Code as independent grounds for the dissolution of an agreement, we will deal with other possible grounds for dissolving a leasing agreement in the event of a significant failure by the lessee to meet his obligations.

An analysis of court practice shows that the parties to a leasing agreement, as a rule, do not bring disputes connected with the breach of a leasing agreement to the courts (this rule does not apply to disputes over breach of obligations to make leasing

payments). We can acknowledge that a natural, relatively frequent, basis for the dissolution of leasing agreements is the transfer by the lessee of rights under the agreement in breach of the conditions of the leasing agreement. This includes subleasing the property, unpaid use of the property, using usage right as collateral or as a contribution to the charter capital of companies or associations or as share participation in a production cooperative, etc⁵.

In considering the issue of dissolving a contract in the event of deterioration of the property, we should note that deterioration of the property should be significant. In our opinion, significant deterioration can be understood as actions (omissions) on the part of the lessee as a result of which the consumer qualities of the property change, preventing its use to maximum effect during the entire period of its productive use.

As already noted, contracts are dissolved in judicial proceedings more frequently as a result of non-payment of leasing payments by the lessee. Existing legislation gives the leasing company the right to demand the dissolution of the lease agreement by the courts if the lessee fails to make leasing payments more than two consecutive times after the expiry of the payment deadline.

This definition raises a number of questions, particularly regarding what is understood as non-payment of a leasing payment. For example, is non-payment of the entire sum required to meet this test, or is it sufficient for the payment to be less than the entire sum due in order to have a leasing payment declared unpaid?

In our opinion, incomplete payment of a leasing payment, on the condition that this is systematic (more than twice in succession), is grounds for the dissolution of an agreement. This position is based on general provisions of the law of obligations⁶. In signing a leasing agreement, the lessee takes on the responsibility of meeting obligations properly, the essence of which is the timely and full payment of leasing payments. In accordance with article 408 of the Russian civil code, only proper implementation terminates the obligations. Consequently, in the event of non-payment of the full leasing payment (improper performance of obligations), the obligations of the lessee cannot be considered to have

⁵ Article 615 of the Russian Civil Code permits these actions to be carried out only with the agreement of the lessor.

⁶ Article 309 of the Russian Civil Code

been fulfilled, and consequently, the leasing company has sufficient grounds to demand the dissolution of the leasing contract⁷.

We should also note that the right to dissolve an agreement arises if the non-payment of leasing payments is consistent, which is defined as being at least twice in succession. That means that making every other leasing payment may be insufficient grounds to dissolve the agreement on these grounds.

Consequently, the legislator has established sufficiently tough restrictions on the dissolution of leasing agreements in a judicial proceeding, on the grounds set down in article 619 of the Russian Civil Code.

As a result, the role of including clauses in the lease agreement specifying grounds for the dissolution of agreements increases significantly. The inclusion in an agreement of provisions for the early dissolution of the agreement in the event of non-payment more than two times not in succession, or non-payment in full over a certain period of time, could simplify the procedure of judicial settlement of disputes. This possibility is presented by the same articles of the Russian Civil Code (450 and 619). A natural requirement, which the legislator sets forth as grounds for the dissolution of an agreement, is the significant nature of the violation

carried out by the lessee. Some major corrections to this problem were made by Informational Letter No. 66 from the Russian Supreme Arbitration Court Presidium from 11.01.2002 «Review of Practice of Resolving Disputes connected with Rental»⁸. In line with point 26 of this document, a one-time failure to make a leasing payment is considered grounds for dissolving a leasing agreement on condition that the corresponding clause is contained in the leasing agreement. As we have already noted, non-fulfillment by the lessee of his obligations should be significant in character. It is also obvious that in considering a dispute, the court will first of all pay attention to this factor. However, given that in the majority of cases the

⁷ A similar position was reflected in an informational letter from the Supreme Arbitration Court Presidium from 11.01.2002 «Review of Practice of Resolving Disputes connected with Rental.» According to point 28 of this document, a leasing agreement may be dissolved as a result of non-payment of rental charge in full, if the court declares this violation significant.

⁸ This particularly applies to confirmation by the Supreme Arbitration Court of the possibility of unilateral withdrawal from a leasing agreement in the event of a one-off failure to make a leasing payment on condition that the corresponding grounds are contained in the text of the leasing agreement.

Securing of suit

The procedure of judicial dissolution of an agreement may take a long period of time, during which the property in the possession of and used by the lessee may be alienated, damaged or destroyed by the lessee. Even the simple use of the leased asset may lead to significant deterioration of the property, reducing its market value. A way out of this situation may be for the lessor to take steps to ensure securing of suit. Issues regarding securing of suit are regulated by article 7 of the Arbitration Procedural Code of the Russian Federation (hereafter the Code). Securing of suit is admissible at any stage of the arbitration process, if not, taking this step may complicate or make the execution of court acts impossible.

Measures to secure suit, applied during the hearing of a dispute arising from a leasing agreement, may include seizing property or money belonging to the lessee.

In accordance with article 51 of the law "On Execution Proceeding," arrest of the property of the debtor is understood as a ban on the disposal of this property and, if necessary – restricting the right to use the property, alienate it or transfer it for storage. Positive aspects of ensuring measures to execute a suit include rapid court decisions on securing of suit. In line with article 75 of the Code, an application to secure suit is heard by the Arbitration Court resolving the dispute not later than the day after the appli-

cation is made and the court's ruling is implemented immediately, in line with the procedure set down for the implementation of the Arbitration Court ruling.

It is also necessary to consider that arrest may be placed both on the leased asset and on any property belonging to the lessee, in addition to funds held in his accounts.

In reaching a decision to seize property, the lessor should take possible negative consequences into consideration.

Restricting the lessee in his use of the leased asset makes it impossible to demand lease payments from the lessee for the period the property is under arrest. In this case the lessor may only demand compensation from the lessee for losses suffered during the period the property is under arrest, and establishing and proving the size of these is quite difficult.

It is also necessary to take into consideration that after the court ruling is enforced, a defendant who has lost the case, has the right to demand from the plaintiff compensation for losses incurred by him by the securing of suit by filing a suit with the same Arbitration Court.*

In addition, the Arbitration Court, in permitting securing of suit may, at the request of the defendant, demand from the plaintiff guarantees for the compensation of possible losses to the defendant.

* Article 80 of the Code.

financing of leasing deals is carried out using credit resources, in our opinion it is totally realistic to prove that the violation of the lease agreement by the lessee is significant (since it may affect the lessor's position vis-à-vis its own creditors).

In the event of the dissolution of a leasing agreement in a judicial proceeding, it is also necessary to take into consideration that the lessor's right to demand the dissolution of the agreement arises only after written warning has been sent to the lessee demanding that he meet his obligations under the agreement within a reasonable period of time. In the event that the lessor has not issued this warning, the right to demand the dissolution of the contract does not arise⁹. In addition, the elimination by the lessee of the violation of the agreement dur-

ing the hearing of the dispute is grounds for refusing the lessor the right to dissolve the agreement¹⁰.

In the next issue of *Leasing Courier* we will deal with other grounds for dissolving agreements in a judicial proceeding, and also with issues regarding unilateral refusal by the lessor to implement a leasing agreement. ■

⁹ See, for example, *Supreme Arbitration Court Presidium resolution No. 1528/99 from 10.08.1999.*

¹⁰ See supplement to *Supreme Arbitration Court letter No. 14 from May 5, 1997 "Review of Practice of Resolving Disputes connected with the Signing, Amending and Dissolution of Agreements," point 8.*

On Amendments and Addenda to the Federal Law "On Leasing"

Work on improving the law "On Leasing" was carried out over several years. The original law, passed in 1998, played a positive role in establishing leasing and gave a stimulus to the spread of leasing throughout the territory of the Russian Federation. However, practice has shown that the law did not correspond to modern economic realities and erected certain barriers to the development of leasing. According to A.G. Akasov, Deputy Chairman of the State Duma's Committee for Economic Policy and Entrepreneurship, "the old law was full of internal contradictions and did not correspond to other normative acts, particularly the Civil Code of the Russian Federation and the UNIDROIT convention "On International Financial Leasing," which Russia joined in 1998.

Both lawyers and representatives of the leasing sector alike believed that the law needed serious corrections, however discussions were long and heated about which amendments to the law should be made.

Parliamentary hearings took place on October 3, 2000 in the State Duma on "Primary Directions for the Development of Leasing in Russia." Deputies discussed issues connected with the regulation of leasing with leasing theorists and practitioners, and noted ways for the further development of leasing. At that time there were four draft laws introducing amendments and addenda to the law "On Leasing" being considered by the State Duma, each of which had positive and reasonable aspects. Participants in the parliamentary

hearings decided to set up a working group as part of the State Duma Committee for Economic Policy and Entrepreneurship, consisting of representatives from leasing companies, small businesses, financial institutions, business support structures and the federal and regional administrations. The main task of the working group was to develop a single draft law on amendments

and addenda to the federal law "On Leasing." In addition to the law "On Leasing," the working group also considered draft laws that amended tax, customs and currency legislation, pertaining to financial leasing. In particular, a large portion of the working group's time was devoted to improving the chapter "On Profit Tax" in the draft Second Part of the Tax Code.

On December 26, 2001, the State Duma voted to pass the law "On Amendments and Addenda to the Federal Law 'On Leasing,'" on January 16, 2002 it was approved by the Federation Council and on January 29, 2002, the law was signed by the president.



The amendments to the law "On Leasing" remove the shortcomings of the law "On Leasing" from 1998 and also add new civil law regulations aimed at encouraging the development of leasing.

In general, the amendments to the law "On Leasing" represent an important step on the road to setting up a stable and unambiguous legislative base for leasing. According to Greg Alton, Project Manager of the IFC Leasing Development Group, whose specialists participated in the working group as part of the State Duma Committee for Economic Policy and Entrepreneurship, "the stability of the legal base is very important for investors that are interested in investing in the leasing sector in Russia, as they need some certainty that the rules of the game will not change arbitrarily and that they will be applied con-

sistently throughout the implementation of a financial project. The amended version of the law "On Leasing," since it removes contradictions between various legislative acts, will stimulate the development of leasing in Russia and help attract both Russian and foreign investment into this sector."

The amendments and addenda to the federal law "On Leasing" came into force from the moment they were published, on February 2, 2002 in the official newspaper Rossiiskaya Gazeta.

Leasing Courier, which has followed the entire process of developing the amendments over the last two years, congratulates all representatives of the leasing sector on the passing of these important amendments and addenda to the law "On Leasing."

LEGISLATIVE NEWS

On November 26, 2001, the Russian president signed part 3 of the Russian Civil Code, which comes into force from March 1, 2002. Part 3 of the Civil Code includes sections that regulate issues concerning hereditary rights and international private law. The norms of international private law have not undergone any conceptual changes from the basic approach of the civil legislation of the USSR and its republics. The legal right of a foreign corporate entity (including the right to carry out leasing activity) continues to be based on the laws of the country where the corporate entity is founded (article 1202 of the Russian Civil Code). International leasing deals, in the absence of a legislative agreement, should be subject to the laws of the lessor's country (article 1211 of the Russian Civil Code). We should note that the norms of the newly passed part 3 of the Civil Code are more comprehensive and detailed, therefore when entering into international deals it is necessary to become more familiar with the corresponding articles of the aforementioned legislative act.

On November 27, 2001, the Russian president signed Federal Law No. 184-FZ "On Amendments and Addenda to the Second Part of the Tax Code of the Russian Federation and Article 20 of the Law of the Russian Federation on the Basis of the Tax System in the Russian Federation." This law adds chapter 27 - "Sales Tax" - to part two of the Tax Code. The addition is of a temporary nature, i.e. comes into

force from January 1, 2002 and remains in force only until January 1, 2004. From the moment chapter 27 - "Sales Tax" - of the Tax Code comes into force, leasing payments paid by the lessee - an individual entrepreneur - by transferring funds from the entrepreneur's bank account are not subject to sales tax.

Federal Law No. 115-FZ "On Counteracting the Legalization (Laundering) of Revenue Received by Criminal Means" comes into force from February 1, 2002. This law has a direct relationship to the implementation of leasing activity, as leasing deals amounting to or exceeding 600,000 rubles are subject to compulsory control. In connection with this, leasing companies are obliged to provide information on these deals to the corresponding authorized body - the Russian Committee for Financial Monitoring.

On January 1, 2002 the Russian government passed resolution No. 1 "On the Classification of Fixed Assets included in Depreciation Groups." This classification was confirmed in line with article 258 of chapter 25 of the Russian Tax Code - "Corporate Profit Tax." The classification of fixed assets is applied when calculating profit tax from January 1, 2002 and may also be used for bookkeeping purposes. If we compare the period of time set earlier by the Unified Norms of Depreciation Payments, established by resolution No. 1072 from the Council of Ministers of the USSR from 22.10.90 and the period of time based on the aforementioned classi-

fication, then we see that the service life of fixed assets in depreciation groups has been reduced in the majority of cases.

On November 14, 2001 the Russian Central Bank submitted directive No. 1050-u "On Establishing a Limit for Cash Settlements in the Russian Federation between Corporate Entities for One Deal." According to this document the limit for settlements in cash between corporate entities for one deal has been increased from 10,000 rubles to 60,000 rubles.

On December 13, 2001 the Russian Justice Ministry registered decree No. 942 from the Agriculture Ministry and State Standard No. 318 from Septem-

ber 27, 2001 "On Amendments and Addenda to the Directive on Certification of Self-Propelled Machinery and Other Forms of Technology." The amendments relate to the system for registering self-propelled machinery and other forms of technology that are leased assets. In particular, it specifies that in registering machinery supplied under a leasing agreement, information on the ownership is included in the certification based on an agreement between the lessor (sublessor) and the lessee dealing with the inclusion of the machine in accounts and on registering it in the name of one of the sides to the agreement, except when otherwise stated by law.

THE IFC TAKES ITS LEASING EXPERTISE TO CENTRAL ASIA

*Rachel Freeman, Project Manager
IFC Central Asia Leasing Project*

The International Finance Corporation has recently expanded its efforts in the leasing arena to Central Asia – in the Kyrgyz Republic, Uzbekistan, Tajikistan, and Turkmenistan -- with the goal of increasing the use of lease financing as a mechanism for private enterprise growth in these four countries, thereby creating a more attractive environment for foreign and domestic investment in Central Asia. This new IFC project has been funded by the Swiss Secretariat for Economic Affairs (SECO), and is being managed by the IFC's Private Enterprise Partnership (PEP) in conjunction with the Russian Leasing Development Group.



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The IFC PEP Central Asia Leasing Project provides technical assistance to Central Asia governments, banks, non-bank financial institutions, and entrepreneurs on the creation and expansion of lease financing in the region. The IFC is currently working in the four Central Asia countries to

create appropriate leasing legislation and soon will organize a series of seminars and individual consulting services to local enterprises and foreign investors interested in developing leasing in Central Asia. The IFC also plans to launch a public education campaign to educate private enterprises, financial institutions and regulatory agencies on leasing. An office staffed with local professionals will be opened in each country,

though in addition, the Russian Leasing Development Group in Moscow will provide expertise and support to the new Central Asia Leasing Project offices.

The Leasing Market in Central Asia

Leasing as a mechanism for business financing is still in its early stages of development in Central Asia. Right now, only Uzbekistan has a working leasing legislation and a few leasing companies operating in the market, while the other three countries are in the process of developing and passing leasing legislation to start a leasing industry. Furthermore, the leasing industry in Uzbekistan is severely hampered by the relative inability to convert Uzbek soum into hard currency. The few leasing companies that are active in Uzbekistan experience constant problems due to the legislation and have almost had to disband their operations and/or lose their foreign partners. This situation is in stark contrast to the significant market for leasing in small businesses in Central Asia, particularly in the area of agri-business, as estimated by the International Finance Corporation.

The transition to a market economy in Central Asia has forced companies to restructure to address a whole host of new issues, including competition, an unstructured customer base, and limited financial resources. In order to survive in this fragile market, companies must modernize their technical knowledge, acquire greater flexibility in the marketplace, and be able to quickly change the focus of their company or their product line. To achieve this transition, Central Asia companies need access to new, more flexible types of financing and must look to partnerships with international organizations that can assist in attracting foreign and domestic investment. The introduction of leasing into the economy will have a positive impact on these local companies' ability to grow and expand over the near future.

Leasing's Effectiveness in Developing the Economy

Leasing today is one of the most important medium-term financing tools throughout the whole world, for both small businesses and multi-national corporations. Leasing is profitable for all parties involved. Lessees are able to make capital investment in their businesses, for a relatively small amount of up-front investment. Additionally, lessees are able to generate more capital through the use of the equipment and use this capital to pay for the equipment because they have already put the equipment to use before having to pay for the equipment. With leasing, lessors have a fairly risk-free method for financing businesses, because they maintain ownership of the equipment until it has been completely paid off by the lessee. Also, lessors are able to have greater control over their investment through regular monitoring of the equipment instead of having to monitor working capital loans. For suppliers, leasing is a way to increase their customer base without increasing their advertising costs.

Leasing has increasingly become a topic on demand in Central Asia. In the Kyrgyz Republic alone where there is little to no leasing, one bank which has 7,000 clients has said that 1000 clients have asked for leasing. Currently, small businesses receive their financing either from banks, at very high interest rates and for short terms, or from friends, relatives, or in the bazaars. It has been estimated that two or three leasing companies in Kyrgyz Republic could operate profitably and serve the small and larger business market.

The Central Asia Leasing Project predicts that a leasing law will be in place in winter, 2002 for the Kyrgyz Republic.

A draft law has been developed and has been sent to Parliament for passage, but this is only the first step in creating a favorable climate for lease finance. Several important measures in the tax and customs codes will have to be amended in order to launch a leasing industry in the Kyrgyz Republic.

In Uzbekistan, while there is leasing legislation that creates a general framework for leasing, the current law and existing legislation on currency conversion make leasing difficult to use. But there is momentum to enact reforms that would positively affect leasing in Uzbekistan. The currently operating leasing companies and the Academy of Banking have been cooperating to develop a list of requests to present to the government for a more suitable leasing legislation. Recently, the IFC and the European Bank of Reconstruction and Development through Baker & McKenzie have been meeting with a working group of leasing companies and government officials to propose amendments to the legislation. In the meantime, the leasing companies in Uzbekistan have turned their attention to leasing in the local currency and are actively looking at the micro and small business market for leasing.

In Tajikistan and in Turkmenistan, leasing operations are at a nascent stage; however, the Tajikistan government has expressed interest in supporting leasing and plans to pass legislation in 2002. The agro-processing sector offers the greatest immediate promise for leasing, with the added benefit of a SME focus. In contrast, there have been a few leasing deals executed in Turkmenistan; however, again similarly to in Uzbekistan, the current foreign exchange conversion policy will be a significant constraint to the development of the leasing industry in Turkmenistan.

The IFC Central Asia Leasing Project views the potential for leasing in Central Asia positively, and that each country can support several leasing companies, both for small and even microbusinesses and for larger businesses.

The IFC Central Asia Leasing Project is available to your questions regarding leasing and the focus of the project. If you have questions, please contact Fatima Eshimbekov, Team Leader, IFC Central Asia Leasing Project at (996312) 610-650, Feshimbekova@ifc.org or Rachel Freeman, Project Manager, at (095) 755-8818, Rfreeman@ifc.org.

The Central Asia Leasing Project is funded by the Swiss Secretariat for Economic Affairs (SECO).

PROJECT NEWS



Greg Alton assumed the position of Project Manager of the Leasing Development Group in November. Greg has been working as Deputy Project Manager since May 2001.



Jim Gorham, who previously held the position of Project Manager, is remaining in Moscow and will continue to work in the leasing sector. The Leasing Development Group wishes him success in his future career.

SEMINARS IN MAGADAN

*Eleonora Veitsman
Public Relations Specialist
IFC Leasing Development Group*

On October 15–16, 2001, the IFC Leasing Development Group conducted two educational seminars on leasing in Magadan: “Legal and Economic Aspects of Leasing Activities” for women entrepreneurs and “Leasing as an Effective Mechanism for Renewing Fixed Assets,” whose participants were gold-mining enterprises in the region. Sixty-five people took part in the Leasing Development Group’s seminars in Magadan.

On October 16, the Leasing Development Group held a press briefing for regional media, which was devoted to questions on development of the leasing market in Magadan Region. Those taking part in the briefing included V.N. Makurin, Deputy Head of the Department of Industry of the Magadan Regional Administration; James Gorham, Project Manager of the Leasing Development Group; O.E. Stepanov, Representative for Magadan Region for the leasing company ZAO DAK; B.P. Maksimov, Head of the Sales Department for the Far East for OAO Promtraktor; and A.V. Antoshchuk, a representative of the cooperative OOO Sodeistvie.

In opening the press briefing, James Gorham noted that “enormous investments are required in order to modernize the production facilities of the region’s industrial complex, which is

based on the mining industry. Leasing can help the region solve this problem.”

The Magadan Regional Administration is also pinning high hopes on the new form of financing. In the opinion of V.N. Makurin, Deputy Head of the Regional Department of Industry, the influx of new modern equipment will make life considerably easier for the small Kolyma cooperatives. Today, they mine more than half the gold, and thousands of northerners work for them. These enterprises are virtually unable to acquire heavy equipment or obtain credit, since they cannot provide collateral. This seriously constrains the pace of development of placer gold mining. Therefore, there is an urgent need for leasing services in the region.



IFC organizes special seminars for women entrepreneurs in many regions

Six leasing companies are currently registered in Magadan Region, two of which are actually operating. These are the Moscow company ZAO DAK and Geoleasing, which lease a wide range of industrial equipment to regional enterprises, for example, construction, printing, gold-mining, and medical equipment; shop equipment; motor vehicles; and computer equipment. Considering the specific industrial character of the region, the main users of leasing services in the foreseeable future may be branches such as the fuel, log-

ging, and woodworking industries, as well as the food-processing industry, including fish-processing. Companies providing services to the mining sector may also be expected to use leasing to acquire the necessary equipment.

There is a high demand for leasing in the region's gold-mining enterprises. Research conducted by the IFC in August 2001 among 26 gold-mining companies in Magadan Region showed that 20% of the respondents had already used leasing and another 30% were considering it as a possible mechanism for financing acquisitions and modernizing their production base.

A successful example of the use of leasing in the gold-mining industry is the program for equipping mine operators in Magadan Region with leased excavation equipment implemented by ZAO DAK, together with OAO Natsionalny Kosmicheskii Bank, ZAO Kolyma-trakt, and OAO Promtraktor. In the period from January 2000 through April 2001, gold-mining enterprises of the region acquired 18 bulldozers through leasing. As a result, in the words of O.E. Stepanov, representative for Magadan Region for the leasing company ZAO DAK, the mine operators who used the leased bulldozers were able to more than double their gold production.

SEMINAR IN PERM

Elena Markova

Team Leader, Ural Region Leasing Development Group

On November 20, the Ural Region Leasing Development Group conducted a seminar in Perm on "Leasing as a Financial Instrument for Business Development and a Mechanism for Renewing Fixed Assets." The organizers—the International Finance Corporation, the noncommercial partnership Perm Leasing Alliance, and the Perm Regional Administration—held this event within the framework of the exhibition "Entrepreneurship in the Urals and Volga Region 2001."

At present, 30 leasing companies are registered in Perm Region. Twelve of them are actually operating in the market. More than half of the active companies are subsidiaries of banks offering leasing credits; the rest either work for a specific enterprise (for example, Privod Leasing) or are independent. According to expert evaluations, the volume of lease agreements concluded by companies in the Perm Region in 2001 was on the order of 10 million dollars. Managers of Perm-area leasing companies say that this figure may become much higher in the near future.

During the seminar, a press briefing devoted to questions on leasing development in the Urals was held for the local press and TV stations. Those taking part in the briefing included James Gorham, Project Manager of the IFC Leasing Development Pro-

More than 100 small and medium-sized business enterprises took part in the eighth regional exhibition "Entrepreneurship in the Urals and Volga Region 2001." Several districts of Perm and Perm Region organized unified exhibits, which points to heightened attention to the problems of small business on the part of municipalities. The goal of the trade fair was not to show the achievements of small business; it was intended to highlight the problems faced by small enterprises.

According to information from the regional administration, more than 12,600 small businesses are registered (and file with the tax authorities) in the Kama area. Slightly more than 8000 of them are "alive"; that is, they have a nonzero balance sheet. In addition, more than 106,000 individual entrepreneurs are registered. As a whole, about 18% of the population of Perm Region work in small business, which provides 11% of the taxes to the consolidated budget. In the opinion of the leadership of the regional administration, this is not high enough. For every 1000 residents of the Kama area, there are only 2.7 small business enterprises (there are more than 30 in Moscow, and about 80 in the U.S.)."

Noviy Kompanion (Perm)

November 27, 2001

ject; V.A. Chernykh, Deputy Chairman of the Committee for Industrial Policy of the Perm Regional Administration; D.N. Nazukin, Director General of the noncommercial partnership Perm Leasing Alliance; O.V. Ermyshkin, member of the Board of Directors of the noncommercial partnership Perm Leasing



Alliance and Director of the leasing company Razvitie; and Prof. L.V. Shchennikov, Dr. Sci. (Law), and I.A. Reshetnik, Cand. Sci. (Law), authors of the draft legislation "On the Promotion of Industrial Leasing in Perm Region."

At the press briefing, D.N. Nazukin noted that the goal of the seminar was to draw the attention of enterprise managers to leasing as a financial instrument for helping businesses to modernize their production facilities in the most effective way with the smallest expenditures. The Perm Leasing Alliance was founded in October 2001 by three leasing companies: a road-construction leasing company, Razvitie, and Promleasing. The alliance's main activities are directed toward documentary, financial, and accounting support of leasing activities and consulting on legal, organizational, financial, and accounting aspects of leasing operations.

At present, in Perm and the Region, leasing mechanisms are regularly and successfully used primarily in the aviation industry. However, many enterprises in other industries, including representatives of small and medium-sized business, have also realized the need for leasing. The regional administration is also aware of the effectiveness of this financial instrument. The basis of the draft legislation "On the Promotion of Industrial Leasing in Perm Region" has already been worked out. Scholars from Perm State University have been recruited to work on this document.

According to V.A. Chernykh, Deputy Chairman of the Committee for Industrial Policy of the Perm Regional Administration, a local law will help create the legal, organizational, and financial conditions for effective functioning of the leasing mechanism in Perm Region; form a regional leasing services market; and improve the state support mechanism for leasing activities in the area of industrial production at the regional level.

The document provides for the creation of a leasing fund that will be the property of Perm Region. The law specifically defines the main uses of the fund: "the provision of guarantees by the regional administration with the aim of ensuring that lessors fulfill their obligations arising from credit agreements" and "financing of leasing projects through grants that will be offered to lessors to reduce interest rates on commercial bank credits."

"There still remain a number of obstacles to the development of a Russian leasing services market. Banks are often not willing to grant long-term credits. Nevertheless, the lending problem can be successfully resolved by means of attracting funds from individuals and legal entities and funds from a leasing company itself. Incidentally, in the West, where more than half the total volume of investments passes through lease agreements, leasing companies as a rule fully finance the transaction with their own funds. With the exception of some Moscow firms that have been working in this market since the beginning of the 1990s, Russian and, in particular, Perm leasing companies still do not have sufficient capital.

Another obstacle is popular stereotypes. It is very difficult to convince people that today, by carrying out a policy of tax exemptions for lessors, the state is trying to make investors responsible for capital investments entirely by market methods. In this case, a leasing company appears not as an unnecessary middleman, but rather as a completely tangible possibility for reducing an enterprise's taxable base and, accordingly, its expenses. The user must prove his right to equipment precisely through effective use of it."

*Permskii obozrevatel' (Perm)
November 26, 2001*

BUSINESS SIMULATION AND CASE STUDY SEMINAR «TOPICAL QUESTIONS ON PREPARING AND IMPLEMENT- ING LEASING TRANSACTIONS»

On December 20–21, 2001, in Moscow, the Leasing Development Group conducted the training seminar “Topical Questions on Preparing and Implementing Leasing Transactions.” Leasing company managers, lawyers, economists, and financial analysts participated in the seminar.

The seminar “Topical Questions on Preparing and Implementing Leasing Transactions” is a new training module developed by specialists of the Leasing Development Group. The seminar has a practical orientation and is based on real situations and problems that Russian leasing companies face in their work.

On the first day of the seminar, the participants were offered the business simulation “Building Effective Cooperation while Preparing a Leasing Transaction.” In order to take part in the game, those present were divided into teams: enterprises needing financing (potential lessees), leasing companies, and a bank. The teams that were able to conclude a leasing transaction or loan agreement were declared the winners. The goal of the first part of the seminar was to summarize decision-making experience at the stages of preparing and concluding a leasing transaction and to determine the cost parameters of leasing services in a new tax environment.

On the second day of the seminar, specialists from the Ministry of Finance and the Ministry of Taxes and Levies of the Russian Federation presented clarifications of questions on taxation and bookkeeping for leasing transactions. In particular, questions relating to calculation and payment of the Value-Added Tax and accounting for leasing transactions according to the new Chart of Accounts were considered. In the

organizers’ opinion, clarification of questions on taxation and bookkeeping for leasing transactions will enable members of the leasing sector to avoid disagreements with the tax authorities and minimize to a considerable extent the risks of leasing activities.

At the end of the second day of the seminar, the participants analyzed several case studies on

the theme “Solving Problems Arising at the Implementation Stage of a Leasing Transaction.” In particular, the seminar participants analyzed problems encountered by leasing companies when concluding a leasing transaction and questions relating to choosing a source of financing and fulfilling obligations under a leasing transaction. The goal of this part of the seminar was to develop and improve the participants’ skills in analyzing problem situations arising in leasing activities.



The business simulation «Building Effective Cooperation while Preparing a Leasing Transaction».



The case-study seminar «Topical Questions on Preparing and Implementing Leasing Transactions» is a new training module developed by specialists of the Leasing Development Group.

In the near future, the seminar materials will be placed on the Leasing Development Group’s Web site (<http://www.ifc.org/russianleasing/>). The materials may be replicated with a reference to the Leasing Development Group and used when conducting seminars or working with clients.

DISCUSSION OF LEASING LEGISLATION: ROUND TABLE IN ST. PETERSBURG

Tatyana Pozdnyakova

Director of the Petersburg Leasing Association

A round table on the theme "Changes to the legal and regulatory environment governing leasing activity: the Tax Code and Licensing" was held on November 9, 2001, in St. Petersburg. The event was organized by the Petersburg Leasing Association with the assistance of the Leasing Development Group of the International Finance Corporation (IFC). Those taking part in the round table included specialists from the IFC Leasing Development Group, members of the Petersburg Leasing Association, and representatives of leasing companies of the Northwest region.

Recently, a number of changes have occurred in federal legislation governing leasing that have a direct influence on its development. The points in question are Chapter 25 of the Tax Code "Organizational Profit Tax," the law "On Licensing Separate Forms of Activity," and the law "On the Introduction of Changes and Additions to the Federal Law 'On Leasing'". In the opinion of Greg Alton, Project Manager of the Leasing Development Group, who opened the event on behalf of the IFC, the recent legal changes have a progressive character and will promote the development of leasing in Russia. They are also evidence of how the coordinated work of individual participants in the leasing sector, such as the Leasing Development Group, the Petersburg Leasing Association, and leasing companies can help solve the urgent problems facing the leasing sector today.

In spite of different evaluations of the effectiveness of the legislative changes (and the desire for more changes), the round-table participants agreed that the more clear-cut legal framework provided by the recent package of changes will allow Russian businesses to use leasing to modernize their facilities more easily.

Leasing companies that are Association members noted that in St. Petersburg and Leningrad Region progressive local legislation that is stimulating busi-

ness activity in the region has also been developed and adopted. St. Petersburg's investment legislation provides for the possibility of granting tax exemptions to enterprises on separate forms of taxes in addition to exemptions existing in Federal legislation.

Based on this possibility, the Petersburg

Leasing Association has prepared a number of legislative acts that contain provisions at the local level for property-tax, profit-tax, and road-tax exemptions for lessors, on condition that the tax savings are reinvested in the real sector of the economy. The Association has also prepared a draft of the Regulation "On a Competition for Receiving the Status of Authorized Leasing Company of the Government of St. Petersburg," which has been introduced to the City Administration.

In Leningrad Region, work on creating a legal and regulatory environment for leasing is also being carried out. Working groups operating under the Governor of Leningrad Region are developing a draft of the regional law "On the Implementation of Leasing Activity in Leningrad Region." Along with general regulations relating to the control and implementation of leasing activity in the Region, the bill provides for the creation of a guarantee fund in the regional budget that will allow leasing companies to engage more actively in financing small and medium-sized businesses, which has traditionally been considered a riskier form of crediting. ■



Tatyana Pozdnyakova
Director of the Petersburg Leasing Association

PETERSBURG LEASING ASSOCIATION

In Issue 6 (18) 2001 of the "Leasing Courier", we began to acquaint our readers with organizations belonging to the Petersburg Leasing Association. As a continuation of this theme, we present information on the leasing companies Baltic Leasing and RT-Leasing. We asked the heads of these companies to talk briefly about their leasing portfolios, promoters, and distinctive features of working with suppliers and clients.

Dmitrii Viktorovich Korchagov,
Director General of Baltic Leasing



The Baltic Leasing company began operations in 1990, and in 11 years of work, has carried out more than 300 leasing operations at the request of industrial enterprises; transport, shipbuilding, trading, and public catering enterprises;

small business; and municipal government bodies. For example, in 1993, in an effort to support domestic manufacturers, a program was implemented for re-equipping a St. Petersburg pasta factory with modern imported production lines worth \$700 000 U.S., which solved the problem of supplying the city and region with high-quality flour products that were second to none.

The sources of financing for leasing operations are credits from the St. Petersburg Industrial Construction Bank (Promstroibank), our promoter and reliable business partner, and internal funds. During the difficult period of the 1998 crisis, the company's internal funds were invested in leasing operations, which enabled us to not only fulfill our credit obligations on time, but also to end that difficult year with a profit. At the beginning of 1998, we started negotiations with Gradi, a St. Petersburg design studio, on leasing them a four-color offset printing machine costing more than \$400,000 from the HEIDELBERG Company. Just when the negotiations with all parties in the transaction had been completed and agreements had been signed, the August crisis broke out. Understandably, applying to a bank for credit was useless; during that period, banks were not even considering requests for short-term credits. The situation was complicated by the fact that, based on the signed agreements, our foreign supplier had already delivered the required equipment to us in order to demonstrate it at a specialized exhibition

in St. Petersburg. At that point, we made the decision to finance the operation from our internal funds. As it turned out, the decision was absolutely correct. In the period after the crisis, the domestic printing industry experienced exceptional growth. It became advantageous to print things in Russia that had been printed abroad before the crisis. This enabled our lessee to complete the payments ahead of schedule, and Baltic Leasing preserved its equity capital and good relations with its German partner.

Baltic Leasing is a general leasing company. At present, we have about 200 active lease agreements in our portfolio with an average period of three or more years. We finance leasing operations in amounts from \$15,000 to \$6 million, from simple dental units and store equipment for small stores to systems of industrial equipment. One of the most recent large acquisitions was a factory for producing large-format plywood for the Ust-Izhorskii plywood combine. The cost of the equipment, taking customs clearance into account, was nearly \$7 million. The equipment supplier was the Finnish company RAUTE OY. Delivery of and payment for the equipment was carried out in several stages over a period of three months in 2000–2001. With the participation of specialists from the factory, employees of Baltic Leasing's commercial department accepted 51 truckloads of equipment and performed customs clearance.

Baltic Leasing does everything possible to reduce leasing expenses for our lessees. Unfortunately, credit resources from Russian banks are still quite expensive, and the terms that are offered do not correspond to the payback period of many interesting projects. The collaboration of our company specialists with the International Finance Corporation (IFC) within the framework of a bilateral project has led to a positive and very important result for us. In October 2001, the IFC Board of Directors approved the provision of a \$2 million line of credit to Baltic Leasing for a three-year period. This decision was preceded by a lengthy analysis by IFC inspectors and an audit of our

company's accounts according to international standards, which was conducted in depth for the three years 1998, 1999, and 2000 by the international auditing company KPMG.

By receiving IFC credit, we have reason to believe that our company will develop at an even faster pace and that, through us, Russian companies will have the opportunity to obtain lease financing at more acceptable interest rates. Our company's experience in attracting international financing may be useful not only for member-companies of the Petersburg Leasing Association, but also, we hope, for many Russian leasing companies. We would be glad to share this experience with Leasing Courier readers.

Contact telephone/fax: (812) 314-02-67

Sergei Aleksandrovich Siling
Director General of ZAO RT-Leasing



The RT-Leasing company has been active in the leasing services market since 1995 and is one of the founders of the Petersburg Leasing Association. RT-Leasing is structured as a group of three leasing companies, both independent and with the stake of banks as promoters,

which allows us to develop various plans and carry out leasing with the greatest possible effectiveness. The group includes ZAO RT-Leasing, OOO Reliz (a general company), and OOO St. Petersburg Leasing Center (specializing in leasing transportation equipment).

RT-Leasing works with a whole range of industrial equipment for various lines of entrepreneurial activity, including leasing of passenger and cargo vehicles. RT-Leasing's marketing network of suppliers includes both Russian manufacturers and suppliers and dealers for foreign companies, such as GENERAL MOTORS, VOLKSWAGEN, RENZACCI, WOOD MIZER, and others.

The RT-Leasing group participates in the implementation of federal programs: thanks to leasing

projects, 29 communications enterprises in various Russian regions have been re-equipped.

At the beginning of 2001, the volume of our portfolio of leasing transactions was more than 3 million dollars. The structure of the portfolio in 2001 was as follows: 31%, electronic systems; 27%, banking equipment; 23%, transport; 8% production equipment; 5% food-processing equipment; and 2% for office, woodworking, and dry-cleaning equipment.

A distinctive feature of the company's activity is work with small and medium-sized businesses on the basis of transactions from \$3000 for transport and from \$10 000 for equipment. The average size of the transactions is \$50 000–\$200 000; large projects amounting to more than a million dollars are also being implemented. Partnerships with Russian and Western insurance companies reduce the risk of default on lease payments to a minimum.

RT-Leasing takes a flexible approach to solving problems that arise during execution of a lease agreement. A leasing transaction with the Rosmark Company in Novgorod Region can serve as an example. This transaction, valued at \$80 000, was financed by Menatep-SPB Bank. Rosmark produces paper and cardboard, and modernization of its production lines required specific equipment that could only be manufactured on special order. A Czech supplier was chosen. In 2001, a lease agreement was concluded, with the peculiar feature that the equipment was delivered to the lessee in stages: at the same time as the first consignment of equipment arrived in Novgorod Region, the supplier factory was producing the remaining equipment. The risks in this transaction were rather high. The lessee could submit a claim in case of failure to meet the delivery dates. On the other hand, if the lessee turned out to be negligent, repossession of the equipment would be impossible in this case. However, the problem was avoided as a result of proper planning and precise organization of the delivery schedule. All three parties in the leasing transaction were very satisfied. After receiving the equipment strictly according to schedule, Rosmark was able to assemble the production line on time and set up production, and thus make its lease payments on time.

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Dear Readers,

When the LDG organizes seminars on leasing, it often offers modules for small and medium enterprises dedicated to female entrepreneurs. Leasing Courier often writes about lessee firms that are run by these female entrepreneurs. In this issue, we are taking a different approach, and are happy to introduce our readership to a leasing company headed by a female businessperson.

DELTA LEASING FAR EAST, VLADIVOSTOK

Viktoria Struts interviews Larissa Anatolevna Sidyuk, Director General of the leasing company Delta Leasing Far East.

Judging from its name, your company's area of operation doesn't just include Primorye.

ZAO Delta Leasing Far East has its head office in Vladivostok, which also works in Ussuriisk, Nakhodka, and other cities of Primorye Territory. Our company also has branches that service enterprises in Khabarovsk Krai and on Sakhalin Island.

What is the average size of agreements and the average periods?

Since May 2000, 35 lease agreements have been concluded. The average amount of an agreement is \$80,000. Since most of the transactions are concluded for a three-year period, all agreements are still in effect.

Are there specific regional characteristics of the demand for equipment and what, in general, is in demand?

Today equipment is financed in very different industries: manufacturing, trade, and transport. The structure of our portfolio is 41% food-processing, 22% consumer goods production, 15% store equipment, 15% forest industry, 3% construction industry, and 4% other. Judging by the number of submitted requests and equipment acquired to date, the fastest developing industries in the territory are food-processing (equipment for fish processing and water bottling makes up the largest share) and forestry (logging and woodworking).

How does the company avoid risk?

Of course, as a creditor granting financial resources for a three-year period, we are exposed to risks that can't be completely avoided. Our task is to minimize these risks without creating too rigid

a framework for our clients. This is achieved by going through five stages of work on a project: 1) checking the current condition of the enterprise and eval-

Delta Leasing Far East was registered in December 1999 and began operating in May 2000. The parent company is the USA–Russia Investment Fund, and financing is currently carried out with the funds of this investment corporation.

uating the effectiveness of the project, 2) evaluating the liquidity of the equipment being leased, 3) working with the equipment suppliers, 4) documenting the transaction, and 5) monitoring.

Let's take a detailed look at each of these stages.

At the first stage, we have the most difficult task: to determine the actual state of a business, since the financial reporting of many enterprises gives a rather distorted picture. The broad experience in crediting small and medium-sized businesses that most of our employees have, thanks to collaboration with the Investment Fund over a number of years, helps us to resolve this problem.

As practice has shown, the second stage is frequently connected with the specific character of the Far East. Large enterprises may be able to acquire high-quality European and American equipment, while small businesses prefer to buy Chinese or Korean equipment, which is aided by the proximity of what is for us the "Near East"; there is also demand for used equipment. The liquidity and quality of such equipment is extremely difficult to determine. In these cases, we turn to professional evaluators and technical experts to determine the actual cost of the equipment.

Third, since 50% of the suppliers for our projects are located in or have representative offices in the western part of Russia, we attach great importance to checking the reliability of suppliers. In the process of working with suppliers, we try to reach purchase and sale agreements through which we and the lessee can jointly monitor whether the supplier is fulfilling his obligations.



Specific equipment is not uncommon in the company's lease portfolio

The fourth stage includes legal aspects of the leasing transaction to protect our interests and the return on investment. We consider an advance payment from the lessee of 25% of the equipment cost and additional guarantees to be the main security. In some cases, if the liquidity of the leased asset is in doubt, a pledge of property from the lessee or the promoter is a possibility.

The final stage: since a lease agreement is concluded for a relatively long period, monthly monitoring is a significant factor in reducing the risk of non-payment. An ongoing dialog with the lessee allows us to avoid unpleasant "surprises" and also makes it possible, if necessary, for the lessee to obtain timely advice from our legal, financial, administrative, and other specialists.

Are there problems in your company's operations?

They are no different from the problems that other leasing companies are trying to solve; in most cases, they are connected with the more global problems of government policy with respect to leasing.

This includes shortcomings of the legal and regulatory environment—up to the adoption of the recent amendments, there was no correlation between the

general regulations of the legislation and the procedure for recording leasing operations bookkeeping accounts. The contradictions between the law on leasing, the Civil Code, and the Tax Code led to different interpretations of the legal and regulatory documents admissible in various regions of the country. The correctness of a record or execution of a transaction often depended on the subjective opinion of one or another civil servant. Therefore, in my view, the work on eliminating existing problems and contradictions being carried out by IFC together with other participants in the leasing market is extremely important.

Speaking about the leasing sector in Russia as a whole, what are its main problems and what, in your view, might be ways to resolve them?

Besides the legislative problem, there are also a number of questions concerning the economic prerequisites for the future formation and development of the leasing services market. One essential condition is the presence of a sufficient number of leasing companies with stable sources of medium- and long-term financing. This is especially urgent for the Far Eastern market, where a large imbalance between demand and supply exists.

The second condition is access to leasing information for a wide circle of enterprises. Today, besides the Leasing Courier, we have no printed materials that would cover the topic of leasing, and few educational events are held where information could be obtained on what leasing is and what its merits and advantages are in comparison with other financial products. In 2002, we are planning to conduct a number of lectures and seminars with other leasing companies and publish informational materials in the local press.



Production equipment leased by Delta Leasing Far East

In conclusion, what about the company's plans and prospects?

I think that our company's prospects for future development are completely realistic. The presence of a stable source of financing allows us to consider longer term and more capital-intensive projects and to continually increase our leasing transaction portfolio. At present, the possibility of geographic

expansion is being intensively discussed; we're working to extend our activity to more distant parts of Primorye and Khabarovsk territories and Sakhalin Region. The question of opening a representative office in one of the cities in Siberia is also being considered.

Thank you for the interview. Good luck to you and Delta Leasing Far East!



RUSSIAN LEASING NEWS

COMMERCIAL TRANSACTIONS

Scrap metal processing in the Urals will be carried out with leased Italian equipment.

The opening of a new section for processing scrap ferrous metal fitted out with brand new equipment from the Italian firm Colmar took place at the Ekaterinburg-Vtormet Company. Ekaterinburg-Vtormet obtained credit for the lease purchase of the equipment from the Severnaya Kazna Bank. Only the Magnitogorsk Metallurgical Combine has similar equipment from Colmar; however, at Ekaterinburg-Vtormet the latest modification has been installed. "Three times fewer workers are needed to maintain our line," said Vladimir Putilin, Director General of ZAO Ekaterinburg-Vtormet. With the introduction of the new production line, the factory will be able to increase its output to 240 000 tonnes of scrap per year.

*Ural Business News Information Agency,
November 5, 2001*

Within the framework of a "pilot" project for intergovernmental leasing, OAO Kaluga Turbine Factory (KTF) and the Saturn Scientific and Production Organization (SPO) will build electric power stations in CIS countries using leased power-generating equipment. OAO Kaluga Turbine Factory, which is involved in development work in the area of surface-based industrial systems, considers OAO SPO Saturn as its base partner in the manufacture of combined-cycle plants with steam

turbines up to 37 MW. The cooperation of KTF and Saturn calls for construction of electric power stations based on combined-cycle capacity of up to 140 MW in Russia, CIS countries, and abroad. The collaboration between KTF and Saturn has been implemented in accordance with the August 10, 2001, decision of the Board of the Leasing Confederation of the CIS, which approved a 5-year "pilot" project for intergovernmental leasing of power-generating, energy-saving, and environmentally safe equipment manufactured by KTF. Specifying SPO Saturn as the base partner for the combined-cycle project was a step toward cooperation of the two companies in the development of domestic construction of gas turbines for surface use on the basis of leasing. At present, work on building surface power plants for the energy and gas industries is being carried out at SPO Saturn on the basis of aircraft technology.

SPO Saturn has experience in realizing prospective projects by means of setting up leasing companies. A leasing company oriented to aircraft manufacturing was established at Saturn. A project for producing tractors with SPO Saturn diesel engines is being carried out on a leasing basis with the Ukrainian enterprises OAO LTZ and state enterprise PO YuMZ.

*Finmarket Information Agency,
November 14, 2001*

Within the framework of an agreement on collaboration between Kabardino-Balkariya and OAO KamAZ Kama Car Factory, leased equipment will be supplied to the North Caucasus. A KamAZ North Caucasus motor-vehicle servicing station will be

built in Nalchik at the OAO Transagroservis depot; 51% of the charter capital will come from KamAZ, and 49% from Kabbalkselkhoztekhnika. The new center will promote KamAZ production in the North Caucasus and will provide presale, warranty, and repair services. The delivery of 50 special power units to Kabardino-Balkariya—engines for KhTZ-1500 and T-150 tractors, and then for other agricultural equipment, i.e., for Don-1500 and E-281 combines—is planned in the near future. In addition, KamAZ is prepared to supply 16 NefAZ city buses to the republic by direct payment and 35 buses under a leasing plan.

*Yuga (Nalchik),
November 15, 2001*

BANK FINANCING OF LEASING

Export-Import Bank USA (Eximbank) and the Delta Leasing company, a subsidiary of the Russia-USA Investment Fund, have signed a memorandum of cooperation to provide deliveries of American equipment to Russia. Eximbank is an independent federal agency that assists in financing the export of American products and services by insuring export credit and offering credit guarantees and straight loans. In the 2001 fiscal year, Eximbank sanctioned the payment of 156 million dollars to support American exports to Russia. Delta Leasing was established in Russia in 1999, and since beginning operations, it has leased production equipment for 200 projects in 12 regions of the country. The company's project portfolio is currently valued at 15 million dollars.

The document signed by Eximbank and Delta Leasing was witnessed by US Trade Secretary Donald Evans, who headed the American trade mission that visited Russia in October. According to the terms of the memorandum, a leasing program aimed at expanding deliveries of American production equipment and providing services to small and medium-sized Russian businesses is to be developed.

*Novosti Russian Information Agency,
October 16, 2001*

The European Bank for Reconstruction and Development (EBRD) considers investments in Voronezh and Lipetsk regions to be promising. After visiting these regions, Bank experts concluded that the investment climate there was favorable and announced that the EBRD was interested in expanding cooperation. In 2002, Lipetsk and Voronezh regions will become priorities for the Bank, in particular for its Small Business Support Fund. Projects for waste treatment, water supply, and improving the

infrastructure of municipal organizations will be considered first of all. Investors also affirmed their interest in increasing cooperation with Lipetsk Region at the IV Moscow-Invest 2001 Forum held in Berlin on October 10–13. In particular, the KLAAS and Agrotex companies expressed their readiness to work with the region by means of leasing equipment.

*Rosbalt Information Agency,
October 17, 2001*

The Northwestern bank of Sberbank of Russia has opened a 2-year 42.8-million-ruble credit line for OOO Globus Leasing. The credit funds will go toward the purchase of 100 Gazelle and 35 Ford Transit minibuses for the purpose of subsequent leasing to AOOT Tretii Park. In the period 1997–2000, the company leased 416 minibuses.

*Delovoi Peterburg (St. Petersburg),
October 8, 2001*

The Syktyvkar branch of GUTA Bank has granted credit for implementing a leasing program to acquire passenger buses for the Komi Republic. Credit in the amount of 56 million rubles has been granted for a period of one year. The buses will be operated by the State Unitary Enterprise Komitransavto. As the Ministry of the Timber Complex, Mechanical Engineering, Transport, and Communications of Komi reported, 70 million rubles from the Republic's budget will be allocated for implementing the leasing program for acquiring passenger buses to the end of the year. A total of 120 new LiAZ, PAZ, and GAZ buses will be purchased with these funds. Delivery of the vehicles will be handled by Gosinkor Leasing, a subsidiary of the State Investment Corporation (Gosinkor).

*Komsolmolskaya Pravda – Komi (Syktyvkar),
November 2, 2001*

German bank Bankgesellschaft Berlin grants MDM Bank credit amounting to 4.7 million euros for financing leasing transactions in the framework of a project to install the latest steel-casting technology in the Northern Pipe Works. The credit is being granted for a period of 6 years against guarantees from the German export insurance agency Hermes. The funds will go toward financing a project for installing stove buckets manufactured by Manesmann Demag at OAO Northern Pipe Works (Polevsk, Sverdlovsk Region), which is part of the Metallurgical Pipe Company, whose promoter is the MDM Group. Equipment delivery will be carried out on leasing terms by Lizingpromhold, a subsidiary of MDM Bank. Startup of the new stove bucket unit will allow

Northern Pipe Works to increase its production volume and achieve significant savings on electric power. This is the first stage of a major project to install continuous steel casting equipment in the factory.

*Economic and Financial News,
November 28, 2001*

Privolzhsk Leasing Company (PLC), a subsidiary of Sarov Business Bank has started operations. The Privolzhsk Leasing Company, which was established in July 2001 as a wholly owned general leasing company of OAO AKB Sarov Business Bank, has drawn up the first agreements for delivery of equipment, motor vehicles, and computer equipment for a total of 2.5 million rubles. The first client was the Avangard electromechanical factory, which bought acoustical equipment with the help of PLC. At present, a number of other applications for leasing equipment for producing mineral water, for real estate, and for motor vehicles have been submitted. In spite its newness, the process of selling through a leasing company has been activated. Potential clients are also drawn by the possibility of including lease payments in costs, accelerated depreciation, optimizing tax deductions, and the many other advantages of leasing as a means of acquiring expensive equipment.

*Birzha (Nizhni Novgorod),
November 8, 2001*

OAO Inkasbank, through its subsidiaries, has concluded a leasing transaction worth 10 million rubles with the Russian Collection Association of the Central Bank of the Russian Federation (ROSINKAS). For 2001 as a whole, Inkasbank paid out 32.7 million rubles for carrying out leasing transactions with ROSINKAS. The credits were granted for 3 and 3.5 years for the acquisition of special collection vehicles and leasing them for a period of 2.5 to 3.5 years. The total amount of the bank's leasing transactions in 2001 was more than 650 million rubles. Compared to 2000, the amount of leased property acquired for clients increased about 14 times.

*Delovoi Peterburg,
December 5, 2001*

LEGISLATION

The Council of the Republic of Kabardino-Balkariya has accepted the law "On State Support of Leasing Activities" for first reading. The document has been developed on the basis of the Federal law "On Leasing" and is intended to provide support for agricultural producers, industrial enterprises, and tourist

and resort services. The law provides for development of a program in the republic for increasing leasing activity, a stake of the republic's budget for the acquisition of equipment and pedigreed cattle, granting of credits for implementing leasing projects, granting of tax and fee exemptions, and state guarantees.

*Yuga (Nalchik),
November 22, 2001*

LEASING COMPANY NEWS

A new leasing company, Privod Leasing, has been registered in Perm Region. AO Privod specializes in large-sized electrical machinery, the main product of turbine-generator manufacturers. The cost of one machine required for such production can be from 1 to 20 million dollars. According to Aleksandr Mukhin, director of Privod Leasing, the main task of the leasing company in the next one to two years is to carry out major re-equipping of the entire Privod holding company, since renewal of fixed assets is an important condition for favorable development of the enterprise. Privod Leasing will work only with affiliates of the holding, which number more than 40.

*Ural Business News Information Agency,
December 10, 2001.*

A branch of OAO Financial Leasing Company has opened in St. Petersburg. In 2002, its operations are expected to attract a minimum of 80 million dollars to the northern capital. OAO Financial Leasing company was established in 1997. In 2001, 51% of the company's shares were bought out by the state for 1.58 billion rubles in order to be able to carry out various federal programs through it. In addition, 18% of OAO Financial Leasing Company's shares belong to the Government of the Republic of Tatarstan, and 7% to Tatneft.

According to Valerii Krasnyanskii, Director of OAO Financial Leasing Company, the main portion of the funds for implementing leasing plans is allocated from the federal budget. One of the company's main objectives today is a program for leasing TU-214 airplanes. It is expected that two of these airplanes manufactured by the Gorbunov Aviation Plant of Kazan will be leased to Pulkovo Airlines. The cost of one TU-214 is about 25 million dollars. In addition, according to the branch's director, the company will be involved in leasing medical equipment. This will be conducted within the framework of a federal program with a total value of 120 million dollars. About one-third of the funds for this program are allocated from the budget; the remaining funds are tied credits from German and Japanese banks. Besides implementing federal programs, OAO

Financial Leasing Company will also engage in a whole range of commercial projects. For example, the company has already begun negotiations on leasing several MAZ trucks to St. Petersburg enterprises.

*Delovoi Peterburg,
December 14, 2001*

AVIATION

The State Duma has allocated 3 billion rubles for renewing the civilian aircraft fleet. In 2002, airlines will receive these funds for carrying out leasing operations, according to Aleksandr Zhukov, Chairman of the Duma's Budget and Tax Committee. He also noted that a reliable aircraft fleet was an important state objective and would be reflected in a special federal program.

*ITAR-TASS,
October 20, 2001*

A second passenger airliner of the new generation of TU-214 aircraft produced by the Gorbunov Aviation Plant of Kazan has been leased to Dalavia Airlines of Khabarovsk. The airplane was leased according to an agreement between the Government of Tatarstan, the Khabarovsk territorial administration, the Financial Leasing Company, the aircraft factory, and Dalavia. The Financial Leasing Company currently has 25 contracts for TU-214 airplanes on its order books. Dalavia Airlines announced its willingness to lease another 6 airliners of the same type.

*Novosti Russian Information Agency,
October 23, 2001*

In January 2002, the Russian airline company Vyborg will receive the first leased IL-114-100 airplane. With this delivery, the Chkalov Aviation Plant of Tashkent begins the introduction of the new modification of the IL-114-100 passenger aircraft onto the market. Serial production of the IL-114-100 began last year. Specialists at the Chkalov Aviation Plant expect that the airplane will become widely distributed among local airlines, mainly in Russia and the CIS countries. Its performance characteristics and low cost have also interested customers in the Baltic countries and South East Asia. Lease agreements for the delivery of 10 airplanes have already been signed with the Uzbek company Uz Avialeasing.

*ITAR-TASS,
December 6, 2001*

One billion rubles have been pledged in the 2002 federal budget to support leasing plans

in the Russian aircraft industry. Ilyushin Finance Co. and the Financial Leasing Company, the winners of a tender among aircraft leasing companies, will receive 600 million and 400 million rubles, respectively, from the federal budget to increase charter capital for transferring a controlling block of shares to state ownership. The Ministry of Property will manage the money. Up to now, the implementation of such projects has been held up by the absence of state guarantees for leasing plans. At the end of March 2001, the government approved a scheme of state guarantees for leasing plans, and in August, the tender was announced. The infusion of budget funds into nascent state leasing companies will allow them to carry out certain programs independently. In future, it will be easier for leasing companies to borrow funds and implement projects independently.

*Daily Business Survey,
December 26, 2001*

INFRASTRUCTURE

The addition of new, comfortable, and environmentally safe transport vehicles to the Krasnoyarsk city vehicle fleet was made possible through a lease agreement between AIKB Yenisei Amalgamated Bank and the Sibir Auto Company. Twenty Gazelle minibuses will arrive in Krasnoyarsk from Nizhni Novgorod. After installing Italian gas equipment in them, which will sharply reduce fuel exhaust emissions, the new minibuses will operate on the streets of the regional center.

*Krasnoyarsk Worker (Krasnoyarsk),
October 20, 2001*

A large consignment of leased equipment has arrived in Kazan from Volgograd. The Volgograd Tractor Plant delivered 180 DT-75 tractors to Tatarstan for a sum of more than 60 million rubles. The delivery was made in accordance with an agreement concluded at the end of August 2001 between the official dealer for the Russian Tractor Company factory and the leasing company Tata-gropromkomplekt.

*Devlovyte Vesti (Volgograd),
November 20, 2001*

AGRICULTURE

The President of Russia considers leasing to be the most effective solution to the problem of replacing outdated agricultural equipment. The condition of the stock of agricultural equipment in Russia remains critical: the service period of 60% of the

machines is ten years or more. President of the Russian Federation Vladimir Putin announced this as he opened the outgoing session of the Presidium of the State Council of the RF. In his words, the operating efficiency of the agricultural industry depends on technical re-equipment. Domestic factories can no longer satisfy the demands of the domestic market. The President named leasing as the most effective solution to this problem. However, he emphasized that leasing mechanisms "have so far not been worked out."

*ITAR-TASS,
October 9, 2001*

AO Rosselkhozbank (Russian Agricultural Bank) is being transformed into a banking group that will also include several leasing companies. As reported by the bank's press service, this is being carried with the idea of using the bank as base for creating a national financial credit system for the country's agricultural industry, with consideration of the development practice of large Russian banks. At present, the group includes the subsidiary leasing company Rosagroleasing; the subsidiary leasing company OAO Sibmashleasing, with the participation of OAO Siberian Machine Building Holding (Krasnoyarsk); the subsidiary leasing company OAO RB-Leasing (Moscow) and its Belarussian branch, with the participation of Belagroprombank; the subsidiary leasing company OAO Rostselmashinlizing (Rostov-on-Don), with the participation of OAO Rostselmash; the subsidiary credit organization ZAO Chelyabinsk Commercial Agricultural Bank [a controlling block of its shares (76.3%) was acquired by the Russian Agricultural Bank in April 2001].

*Russian News Agency Ros Business Consulting,
October 4, 2001*

A leasing credit fund will be created in Altai Territory. The project will be supported by the territorial budget, giving firm guarantees to banks that take part in its realization. Yevgenii Rogovskii, First Deputy Chief of the main administrative office of the economy and investments of the Altai Regional Administration said that "a draft resolution for the creation of a territorial leasing fund in which we propose to allocate financial resources to establish a leasing fund from territorial resources when formulating the territorial budget for 2002. The fund would be made up of resources amounting to 150 million rubles used in 2001 for leasing agricultural equipment in the "Agriculture" division and capital investments amounting to 50 million rubles." Creation of a leasing credit fund should help solve the problem of renewing the

equipment base of the agricultural industry and development of a leasing system in Altai.

*Business for Everyone
October 29, 2001*

In 2002, 109 270 000 rubles from budget funds will be allocated for leasing in Rostov Region. Credits from the regional budget will be offered to agricultural producers in the form of long-term leases in the amount of 91 270 rubles for a period of up to 5 years; credits in the form of medium-term leases to support small business will be offered in the amount of 3 million rubles for a period of up to 3 years, and to support other enterprises, in the amount of 15 million rubles for up to 3 years. Budgetary loans for reconstruction of housing stock (12.3 million rubles for up to 2 years), for mortgage credit loans (35 million rubles for up to 10 years), and for other purposes will also be offered. Agricultural enterprises will also receive 420 million rubles to purchase equipment (210 million rubles in the fiscal year and 210 million rubles paid off in 2003).

*Russian News Agency Ros Business Consulting,
December 12, 2001*

Renewal of the farm equipment stock in Krasnodar Territory will be carried out through leasing. This decision was made at a meeting of the territorial administration, at which representatives of the territory's city and district administrations, managers of large banks, leasing companies, and industry were present. According to official information, in the first eight months of 2001, the number of tractors in the territory decreased by 8% and grain-harvesting equipment by 9%, while the renewal percentage was too small—from 1 to 3%. More than half of the farms in the territory are in a shaky financial state and have large debts that have not been repaid for years. Therefore, from the point of view of the territorial authorities, the most promising forms of financing for agriculture are commercial crediting and leasing. As Vice-Governor A. Remezko said at the meeting, in 2002, the territory will be active in introducing leasing programs. In his words, 2 billion rubles will be allocated from the budget for leasing agricultural equipment.

*Kubanskie Novosti (Krasnodar),
December 14, 2001*

The allocation of 14.8 million rubles to acquire machinery for enterprises of the agricultural industry in Novgorod Region is proposed for 2002. The necessity of creating a regional agrarian leasing fund was discussed long ago. There was no

Federal leasing in the past year, and the promised funds from the Federal leasing fund for purchasing equipment in the region were not forthcoming. Now, funds from the regional leasing fund will be allocated to each district (in effect, this will be long-term interest-free investment credit for a period of five years) to implement leasing programs. As was emphasized by the Regional Agricultural Committee, in the first place, large farms will become lessees.

Novgorodskie Bedomosti (Novgorod),

December 21, 2001

SMALL BUSINESS

A business incubator for small business will be opened in Tyumen Region. The regional administration plans to direct 1 008 000 rubles for its creation within the framework of a support program for small business. The incubator will continue to work on creating a support infrastructure for small business. In the opinion of the program's developers, micro-crediting for beginning and very small businesses will be an important component of financial support for entrepreneurs. One of the priorities of the program is the development of leasing for small businesses. In 2002, there is provision for an allocation of 850 000 rubles from the regional budget for these purposes.

Sibirskii Posad (Tyumen),

December 4, 2001

FOREIGN LEASING NEWS

A number of financial credit institutions in Romania and Moldova have signed joint Protocols on financing lease sales of automobiles to legal entities in the Republic of Moldova. The document was signed by the Romanian company AO Asigurarea Populara Romana, the Chisinau branch of AO Banca Comerciala Romana, the Donaris Group insurance association, and WEBO, a Moldovan enterprise with foreign capital. The lease sale method is widely used in commercial relations in Western European countries. The introduction of this mechanism opens up new opportunities for expanding trade relations between economic entities of the two countries.

National Press Agency MOLDPRESS (Moldova),

October 18, 2001

The Lithuanian bank Lateko, which began its operation with leasing, has entered the Lithuanian financial services market. Lateko is a leader in Lithuania in the area of consumer leas-

ing; its leasing portfolio is worth 5 million dollars (20 million litas). According to Igor Bukovskii, Vice-President of the bank, Lateko has been fortunate in finding a still-unfilled leasing niche in Lithuania and plans to consolidate its hold on it. Lateko lizingas, the leasing company set up by the bank, will offer only consumer leasing, that is, crediting the purchase of goods costing from 500 to 12 000 litas.

Baltic News Service (Riga),

November 9, 2001

The Ukrainian airline AeroSvit has leased two Boeing airplanes. AeroSvit was established in 1994 as a closed joint stock company; 62% of its shares are owned by Ukrainians, and the airline operates flights on 29 routes to 15 countries. At present AeroSvit runs one Boeing 737-200 and two Boeing 737-300s, one of which will be withdrawn from service. Within the framework of a lease contract with the American company CIT Leasing Corporation, AeroSvit will receive two Boeing 737-500 airliners in January 2002. The lease period is 8 years. The new airplanes are distinguished by the presence of special lock chambers between the cockpit and the passenger cabin consisting of two reinforced outer doors. According to Aleksei Kachanov, Deputy Director General of AeroSvit, prices in the aircraft industry market have recently fallen significantly, and airline companies can obtain modern airplanes at a relatively low cost.

UNIAN (Kiev),

November 23, 2001

Malev Hungarian Airlines has signed a contract with the International Lease Finance Corporation to lease new-generation Boeing aircraft. The contract provides for the leasing of 10 Boeing 737-600, -700, and -800 aircraft with an option to buy six 737 models. Malev will begin receiving the airplanes within the framework of this contract in February 2003. The airliners will be operated on flights from Hungary to Europe and countries of the Middle East.

Finmarket,

December 13, 2001

In March 2002, the airline fleet of Armenian Airlines will be reinforced with an Airbus A-310 jumbo jet. This is the second jumbo jet leased by the airline. The Airbus A-310 will be operated on a leased basis for a period of 6 years, after which it will become the property of Armenian Airlines. The monthly payment for the airplane during the lease period will amount to \$125 000 US.

Mediamax Information Agency (Yerevan),

December 26, 2001



Elena Degtiareva, Financial Analyst, IFC Leasing Development Group, answers questions sent in by LC readers

How does a leasing company handle accounting of deposits against lease payments received from a lessee under the new Chart of Accounts?

Deposits are recognized as the sum of money paid out by one of the parties to an agreement against payments owing to the other party under the agreement as proof of conclusion of the agreement and a guarantee of its execution¹. That is, as a guarantee, a deposit also fulfills the function of a settlement, since it is counted against payments owing. There is no separate account in the Chart of Accounts for recording a paid deposit. Since the deposit has a settlement function as a prepayment for goods, labor, or services, a received deposit may be recorded as an advance.

In 1991, account 64 was used to record received advances under the Chart of Accounts; however, in the new Chart of Accounts, there is no provision for recording advances separately. The sums of the received advances and prepayment are recorded as a credit in account 62 "Settling of Accounts with Various Debtors and Creditors," in which there is a special subaccount "Settlements by Received Advances."

In this case, the accounting transactions are as follows:

D51 K62, subacct. "Advances Received" (300) – deposit received

D62, subacct. "Advances Received" K68 (50) – VAT charged

D62 K90-1 (1200) – lease payments charged

D90-3 K68 (200) – VAT charged

D51 K62 (900) – lease payments made

D62, subacct. "Advances Received" K62 (300) – deposit is entered into the lease payments account

D68 K62, subacct. "Advances Received" (50) – VAT is recovered from the deposit sum

A deposit may also be recorded in account 76 "Settling of Accounts with Various Debtors and Creditors." This is the opinion of the Ministry of Finance in its letter No. 04-01-02 "D" of October 28, 1998. In this letter, it is stated that amounts of funds received

as a deposit should be recorded in account 76 "Settling of Accounts with Various Debtors and Creditors," in correspondence with the accounts for recording funds. If the indicated funds are not returnable according to the terms of the agreement, they are written off into the credit of account 46 "Sale of Goods, Labor, or Services."²

An individual entrepreneur not organized as a legal entity and engaged in commercial and agency activities leases a passenger vehicle from a leasing company. The entrepreneur uses this automobile for business trips connected with his business activities. In this case, can the entrepreneur record lease payments made to the leasing company under a financial lease (lease) agreement for a passenger vehicle as professional tax deductions?



Svetlana Kravchuk, Accounting Specialist, IFC Ural Regional Leasing Development Group, answers questions sent in by LC readers

Article 221 of the RF Tax Code stipulates that when calculating the tax base, individuals registered according to the established legislative procedure and carrying out entrepreneurial activities without being organized as a legal entity have the right to receive professional tax deductions in the amount of paid and documented expenses that are connected with revenue earning activities. These expenses, in turn, are taken as deductions by individual entrepreneurs in the same way as organizations when calculating profit tax, that is, with consideration of the relevant articles of Chapter 25 of the Tax Code "Organizational Profit Tax."

According to Subparagraph 10, Clause 1 of Article 264 of Chapter 25 of the RF Tax Code, lease payments on leased property are included in other expenses relating to production and sales.

Thus, individual entrepreneurs have the right to record lease payments made under a lease agreement for a passenger vehicle as professional tax

¹ Article 380 of the RF Civil Code.

² According to the new Chart of Accounts, into the credit of account 90 "Sales", subaccount "Turnover."

deductions, provided that the leased passenger vehicle is being used exclusively for business purposes, that is, for the purpose of gaining revenues. Daily waybills and waybill registration logs for vehicles of an individual entrepreneur that are filled out according to the requirements of the "Procedure for Keeping Waybills during Performance of Hauling Activities by Individual Entrepreneurs," confirmed by Ministry of Transport Order No. 68 of

June 30, 2000, may be used as proof that the leased passenger vehicle is actually being used for business purposes.

Professional tax deductions are granted to individual entrepreneurs on the basis of their written application when they submit their tax declaration to the tax authorities at the end of the taxable period.

How are a lessee's expenditures relating to assembly and setup of leased equipment recorded?

Expenditures connected with upgrading fixed assets to a condition fit for use (assembly, installation, setup) are of a capital nature and are included in the original cost of the unit for both accounting¹ and taxation purposes². At the same time, in accordance with the current version of the Tax Code and in contrast to other property, only the amount of the lessor's costs of acquiring³ a leased asset is recognized as the original cost of the asset for profit-tax purposes. That is, expenditures connected with upgrading fixed assets to a condition fit for use are excluded. There is a high probability that this regulation will be changed in connection with the adoption of amendments to Chapter 25 of the Tax Code and that for tax purposes the cost of leased property will include expenditures associated with putting an installation into operation. At present,⁴ the State Duma of the Russian Federation is considering a draft of these amendments.

Cases are frequently encountered in practice where the lessee independently bears the costs connected with putting leased equipment into operation. In this case, the complete capital investment on leased fixed assets made by the organization that has leased the assets (in our case, this is the lessee) into its own fixed assets to the actual amount of expenditures made⁵.

As far as depreciation on such items is concerned, the procedure for charging it is contained only in the Methodological Instructions on Accounting for Fixed Assets⁶. According to Clause 65 of the Methodological Instructions, capital expenditures on leased fixed assets are depreciated monthly by the lessee during the lease period, based on the method of charging depreciation deductions fixed by the lessor for the item on which the costs were incurred. How-

ever, this document extends the described procedure to items that are returned to the lessor after termination of the lease agreement, which makes it difficult to apply to objects of leasing transactions. In addition, in our opinion, it does not seem to be possible to apply the accelerated depreciation factor to items representing capital expenditures on a leased asset, since on the basis of both the Tax Code⁷ and the law "On Leasing"⁸, the special factor is applied directly to the leased asset only.

In this connection, another option for recording the specified expenditures can be used; in particular, they can be counted as the lessor's costs (which must be specified in the lease agreement) and the original cost of the item can be generated by taking these expenditures into account. If the lessee actually pays the expenses for equipment assembly and



Aleksandr Akimov, Financial Analyst, IFC Leasing Development Group, answers questions sent in by "LC" readers

¹ PBU Regulation "Registry of Fixed Assets," Clause 8 (6/01).

² RF Tax Code, Subparagraph 2, Clause 1, Article 257.

³ RF Tax Code, Subparagraph 3, Clause 1, Article 257.

⁴ As of the end of January 2002.

⁵ PBU Regulation on Bookkeeping and Accounting in the Russian Federation, Clause 5, Paragraph 47 (6/01) (confirmed by RF Ministry of Finance Order No. 34n of July 29, 1998).

⁶ This document is confirmed by RF Ministry of Finance Order No. 33n of July 20, 1998. It should be noted that it has the character of a recommendation and is valid where it does not contradict PBU 6/01.

⁷ Article 259, Clause 7.

⁸ Article 31, Clause 1.

setup, then, in our opinion, these actions may qualify for and be recorded in the bookkeeping records as an advance against forthcoming payments under the lease agreement.

On the lessee's books:

Debit 76 Credit 51 – payment for delivery and assembly services is recorded

Debit 60 Credit 76 – these actions are recorded as an advance paid;

On the lessor's books:

Debit 08 Credit 62 – capital investments are entered on the balance sheet as an advance received.

We should consider separately the procedure for recording capital expenditures on a leased asset in the lessor's tax records before adoption of the amendments to the Tax Code. As already indicated above, at present, these expenses may not be included in the original cost of depreciable property. Thus, they may constitute expenses that are either recorded or not recorded for tax purposes. In accordance with Clause 1, Article 252 of the Tax Code, valid documented expenses are included in costs provided that they are directed toward carrying out an activity for the purpose of deriving revenues. Since a lessor's expenditures connected with putting a leased asset into operation meet the cited criteria, they are included in the costs recorded for taxation. The procedure for writing off these costs must conform to the principal of uniform and proportional generation of revenues and costs⁹.

Thus, before the introduction of the amendments to the Tax Code, a lessor's expenditures connected with bringing fixed assets to a condition fit for use must, in our opinion, be recorded as costs proportional to revenues received (lease payments) for the period of the lease agreement.

⁹ Article 272, RF Tax Code.

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The Leasing Courier information bulletin is distributed free of charge as a part of the Leasing Development Project, implemented by the International Finance Corporation with financial support from the Canadian International Development Agency (CIDA)

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Circulation: 200 copies (English)

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